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No. 87-

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

APPLICATION OF STERLING BANCORP,

Appellant,

v.

NEW YORK CITY DEPARTMENT OF FINANCE and PHILIP R. MICHAEL, Commissioner of Finance,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NEW YORK, APPELLATE DIVISION, FIRST JUDICIAL DEPARTMENT

JURISDICTIONAL STATEMENT

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January 8, 1988

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QUESTIONS PRESENTED

1. Is the use of different standards by New York City in the imposition of its Financial Corporation Tax to determine whether a banking corporation is "doing business" within or without of the City, invalid under the Equal Protection Clause of the United States Constitution?

2. If not, is the denial of an allocation for the income of a foreign branch for the purposes of the New York City Financial Corporation Tax, violative of the Commerce Clause of the United States Constitution as subjecting such income to the risk of multiple taxation since such income could also have been taxed by the foreign government?

DESIGNATION OF PARTIES

The Appellant and Appellees are identified in the caption appearing on the cover and at page one of this statement. Wholly owned subsidiary or affiliated companies of appellant, Sterling Bancorp, are:

Sterling Banking Corporation

Sterling National Bank & Trust Company of New York

Standard Factors Corporation

Universal Finance Corporation

Security Industrial Loan Association

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ON APPEAL FROM THE SUPREME COURT OF THE STATE OF NEW YORK, APPELLATE DIVISION, FIRST JUDICIAL DEPARTMENT

JURISDICTIONAL STATEMENT

Appellant, Sterling Bancorp ("Bancorp"), appeals from the final judgment of the Supreme Court of the State of New York, Appellate Division, First Judicial Department, dated March 10, 1988.[1] The judgment of the Appellate Division confirmed the

[1] By an order entered July 7, 1987, the Court of Appeals of the State of New York dismissed, *sua sponte*, for lack of a substantial constitutional question, a timely appeal from the Appellate Division decision. Bancorp then timely moved for leave to appeal, which was denied by the Court of Appeals, in an order entered October 20, 1987.

administrative decision of appellees, New York City, Department of Finance and Philip R. Michael, Commissioner of Finance (collectively "Finance"), which determined that Bancorp's wholly-owned subsidiary, Sterling National Bank & Trust Company of New York ("SNB"), could not allocate the income of its Nassau, Bahamas branch for the Financial Corporation Tax ("Financial Tax") imposed by the City of New York. Finance based its administrative decision on its erroneous determination that the SNB's Nassau branch was not a *bona fide* branch, despite the fact that such branch was regularly conducting a banking business outside of the United States under the laws of the United States, New York State and the Bahamas. In confirming, the Appellate Division sustained the denial of the right to allocate. Such a denial is impermissible under the Equal Protection and Commerce Clauses of the Constitution of the United States.

Opinions Below

The administrative decision of Finance is not reported but is included in the appendix, starting at 18a.[2] The judgment of the Appellate Division was rendered without an opinion. The order of the Appellate Division is included in the appendix at 33a. The order of the Court of Appeals dismissing the appeal *sua sponte* is included in the appendix at 34a and the order of the Court of Appeals denying Bancorp's motion for leave to appeal is included in the appendix at 35a. Neither order of The Court of Appeals was accompanied by an opinion.

Jurisdiction

The judgment of the Appellate Division upholding the denial of the right to allocate the income of SNB's Nassau branch for the Financial Tax was entered on March 10, 1987. (33a) That judgment became the final judgment of the highest court in which review could be had on October 20, 1987, when the Court of Appeals entered an order denying the motion of Bancorp for

[2] Numbers followed by the letter "a" refer to pages of the appendix hereto.

leave to appeal. (35a) The notice of appeal to this Court was filed in the Supreme Court of the State of New York on December 21, 1987. (36a)

The fact that the New York State Court of Appeals denied Bancorp's request for appeal, finding there were no substantial constitutional issues involved herein, does not preclude this Court from making its own determination of the constitutional questions. "It is settled that [whether] a pleading sets up a sufficient right of action or defense, grounded on the Constitution or a law of the United States, is necessarily a question of federal law; and where a case coming from a state court presents that question, this Court must determine for itself the sufficiency of the allegations displaying the right or defense, and is not concluded by the view taken of them by the state court. *First National Bank v. Anderson*, 269 U.S. 341, 346; *Staub v. City of Baxley*, 355 U.S. 313, 318." *Allied Stores of Ohio, Inc. v. Bowers, Tax Commissioner of Ohio*, 358 U.S. 522, 525 (1958). Thus this Court has jurisdiction in this matter.

This appeal is being docketed in this Court within 90 days from October 20, 1987, the date of entry of the order of the Court of Appeals denying Bancorp's motion for leave to appeal. The jurisdiction of this Court is invoked under 28 U.S.C. §1257(2).

Constitutional Provisions and Statutes

U.S. Const. art. I, §8, cl. 3:

> The Congress shall have Power. . .To regulate commerce with foreign nations, and among the several States and with the Indian tribes.

U.S. Const. Amendment 14, §1:

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall

abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

The pertinent provisions of the Financial Tax, §R46-37.1 *et seq* of the New York City Administrative Code (for the years involved herein) and the regulations of Finance appear in the appendix, starting at 1a. The provisions referred to herein of the New York State Franchise Tax on Banking Corporations, the United States Code and the Code of Federal Regulations appear in the appendix starting respectively at pages 6a, 8a and 16a.

Statement of The Case

Bancorp is a corporation that was formed in 1966 under the laws of the State of New York, which owns all of the outstanding stock of SNB, a "national" bank, that was incorporated under the laws of the United States in 1929. Both Bancorp and SNB have their principal place of business in the City and State of New York. Bancorp filed combined Financial Tax returns with its subsidiaries including SNB in which the income of SNB's Nassau branch was allocated outside of New York City for the taxable years 1980 and 1981.

SNB, with the advance permission of the Board of Governors of the Federal Reserve System (as required by 12 U.S.C. §601), obtained a license from the Bahamian Ministry of Finance to establish a branch in Nassau, Bahamas. The Nassau branch, as a foreign branch[3], was not subject to the restrictions and requirements imposed on branches of banks located in the United

[3] A "branch" is defined in the Federal banking law as any office where any one of the following functions are performed, to wit: (i) the receipt of deposits, (ii) the payment of deposits and (iii) the making of loans. (12 U.S.C. §36(f)). A "foreign branch" is defined as an office of an institution which is located outside the country under the laws of which the institution is organized, at which a banking or financing business is conducted, i.e. receipt of deposits, payment of deposits or the making loans. (12 C.F.R. §211.2(h)).

States and thus it could participate in the Eurodollar banking market.[4] For this reason, SNB, as did many banking corporations in New York and elsewhere in the United States, established such foreign branches.

It is undisputed that the Nassau branch of SNB was, under the laws of the United States, New York State and the Bahamas, a *bona fide* foreign branch which conducted its banking business outside of the United States pursuant to the authority of the license issued by the Bahamas. As an instrumentality of the Bahamas it was only subject to the banking laws and regulations thereof. It was not subject to the Federal and State banking laws, rules or regulations.

Virtually all of the functions of such branch were performed by personnel in SNB's New York City branches, but records were maintained to show the operations of the Nassau branch separate and apart from that of SNB's branches in the United States. The gross income of SNB's Nassau branch was almost entirely from sources outside of the United States, as determined under §862 I.R.C. 1954 (26 U.S.C. §862)[5] and, accordingly, a foreign tax credit would have been permissible under §901 I.R.C. 1954 (26 U.S.C. §901) for any Bahamian income taxes that would have been paid on the income thereof, if such taxes had been imposed.

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[4] SNB, as a national bank, is required to be a member of the Federal Reserve System (12 U.S.C. §222) which requires all member banks to maintain reserves against deposits and, at one time, imposed restrictions on the payment of interest thereon but such reserves and restrictions are not imposed on foreign branches of member banks. (Respectively, 12 U.S.C. §§461(b), 371 b, 12 C.F.R. §§204.1, 204.1(c)(5), 217 and 217.0(d)). Member banks are required to provide FDIC insurance on deposits but not on deposits payable at a foreign branch. (Respectively 12 U.S.C. §§1814(b) and 1813(b)(5)(1)(A)). Since the laws and regulations of many states, including New York, closely follow the Federal laws and regulations many state chartered banks are subject to the same requirements.

[5] The references herein are prior to the enactment of the Internal Revenue Code of 1986. However the Internal Revenue Code of 1986 is the same in this respect.

SNB, as a national bank, was annually audited by the Office of the Comptroller of the Currency (12 U.S.C. §481) who recognized the Nassau branch as a *bona fide* foreign branch.

On July 1, 1983, the New York City Department of Finance issued a Notice of Determination against Bancorp stating that there was a deficiency of City Business Tax (Corporations) aggregating $1,699,278 with interest for the taxable years ended December 31, 1979 to December 31, 1981 attributable to the denial of the allocation of the income of SNB's Nassau branch. Bancorp, as required by law, filed a petition for a Formal Hearing before Finance to contest this deficiency, and such Hearing was held on February 21, 22 and 24, 1984.

THE DECISION OF FINANCE

On July 24, 1984, a decision was rendered by Finance that Bancorp was not entitled to an allocation on the grounds that: (i) the Nassau branch of SNB was not a branch, office or agency where functions were regularly conducted within the meaning and intent of its regulations, although it may have qualified as a "branch" under the Federal and State banking laws, and (ii) SNB's Nassau branch was a legal device, set up for the sole purpose of enabling it to participate in the Eurodollar market, which branch was wholy lacking the attributes of a *bona fide* branch office or agency where its functions were systematically and regularly carried on.[6] (18a)

JUDICIAL PROCEEDINGS

Bancorp instituted a judicial proceeding to review and annul the administrative determination of the Commissioner. It was argued before the Appellate Division of the New York Supreme Court that (i) under the Federal, State and Bahamian laws, SNB's Nassau branch *was* conducting a banking business

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[6] Implicit in this conclusion, is the fact that SNB's New York branches were unable to participate in the Eurodollar market so that its Nassau branch was conducting a business which SNB could not otherwise carry on.

outside of the United States which could not be conducted in New York, (ii) the determination of whether a bank was, "doing or carrying on a business" within or without the City should be made by reference to the banking laws, (iii) the subjective determinations of Finance of a "branch" and "doing or carrying on a business" by reference to its regulations was the use of a dual standard to define such terms which is violative of the Due Process Clause of the United States and New York Constitutions, and (iv) the denial of the allocation for SNB's Nassau branch subjected the income thereof to the risk of multiple taxation which is invalid under the Commerce Clause of the Constitution. Finance argued that SNB's Nassau branch was merely a "shell" since all the activities for such branch were performed by personnel at its New York branches and therefore such branch was not conducting business outside of the City so as to be entitled to an allocation. The Appellate Division confirmed the determination of Finance without an opinion.

Bancorp then brought an appeal to the New York Court of Appeals on the issues relating to the United States and New York Constitutions. That court dismissed the appeal *sua sponte* on the basis that there were no substantial Constitutional issues. Bancorp then made a motion for leave to appeal to said Court which was denied on October 20, 1987.

The Questions Are Substantial

In Affirming the Decision of Finance, The State Court Allowed Finance To Use Two Definitions Of The Term "Doing Business" And To Impose Different Standards On Taxpayers. As A Result Thereof Finance Denied An Allocation Subjecting Income To The Risk Of Multiple Taxation.

The Financial Tax is imposed on banking corporations for the privilege of doing business in the City of New York. This tax was modelled after the New York State Franchise Tax on Banking Corporations ("Bank Tax") and the two tax laws and the regulations thereunder are virtually the same.[7] For purposes

[7] The Financial Tax was authorized by the legislature of the State of New York in 1966, permitting the City to impose various taxes to be modelled after the State taxes. (Laws 1966, Chapter 772, §1). (1a)

of the Bank Tax, the term "doing business" was construed to mean "doing a banking business" and the doing of such business in the State was determined by reference to banking laws. Accordingly, if a foreign bank[8] maintained a branch in New York for which a banking license was required, it was "doing a banking business" in the State and subject to the Bank Tax since a banking license was required therefor. If a bank was "doing business" in the State for which no banking license was required, the bank was not "doing a banking business", and thus, it was not subject to the Bank Tax. This principle was the basis for an *Advisory Opinion of the State Tax Commission to Lloyds Bank of California* (published by the Technical Services Bureau of the New York State Department of Taxation & Finance on September 21, 1982, in TSB-A-82(13)C) (40a) wherein it was ruled that a foreign bank which maintained loan production and/or representative offices in New York was not subject to the Bank Tax, since such offices were not branch offices for which a license was required under §200 of the banking law. Inasmuch as a bank was only subject to the Bank Tax if the bank needed a banking license to conduct activities in the State and such license was required only if the bank maintained a banking branch in the State, the definition of the term "branch" had to be made by reference to the banking law.

This principle had been followed by Finance for purposes of the Financial Tax since it was required by §11 subd. 5 of the Model Local Law contained in the enabling legislation. (2a).[9] Thus, foreign banks which maintained only loan production

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[8] As used herein, banks organized under the laws of a jurisdiction other than the State of New York.

[9] In this connection, Bancorp called Mr. Edward P. Eustace, Deputy Superintendant, Department of Banks of the State of New York to testify at the formal hearing of the Department of Finance, as to (i) the meaning of the term "banking business" under the Federal and State banking laws, and (ii) whether foreign banks which maintain only loan production and/or representative offices in the City and State of New York pay any Financial or Bank Taxes. Upon the objection of counsel for Finance, the Referee held that: (i) since SNB was a national bank, subject to the Federal banking laws, Mr. Eustace did not qualify as an expert to testify on the banking laws, despite

(footnote continued)

and/or representative offices in the City were not subject to State or City taxes. However, if a bank, such as SNB, was "doing a banking business" within the City, so as to be subject to the Financial Tax, a different definition of the term "doing business" was used to ascertain if the business was being done outside of the City so as to permit an allocation. In using this different definition of the term "doing business", Finance has completely ignored the fact that SNB's branch was conducting a banking business outside of the United States that could not, under the Federal and State banking laws, be conducted therein and has used a dual standard in the taxation of banks, which violates the Equal Protection Clause of the Fourteenth Amendment.[10] By using such dual standard, Finance denied an allocation for the income of SNB's Nassau branch and exposed such income to the risk of multiple taxation in violation of the Commerce Clause contained in Article 1, §8 of the Constitution.

1. *The use of two definitions for the term "Doing Business" results in different taxation of the income of different banks.*

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the fact that he had been with the Department of Banks for about thirty years, said Department has regulatory authority over national banks with branches in the State and, of necessity, to have uniformity as between banks, the New York State banking laws and regulations are similar to the Federal banking laws and regulations, (ii) he could not testify as to taxes since he was not an expert thereon, and (iii) an exchange of correspondence between Mr. Eustace and counsel for Bancorp, containing a list of foreign banks that maintained loan production and/or representative offices in the State, was inadmissible as being irrelevant and immaterial.

[10] In the only two other cases in the United States on this point, it was held that banks, for purposes of state taxes on income, should be permitted an allocation attributable to a foreign branch similar to SNB's Nassau branch, *In the Matter of the Petition for Correction of Assessments of Seattle - First National Bank, et al, Before the Department of Revenue of the State of Washington*, Determination No. 76-29 and Supplemental Determination 76-29A (1976)(44a) and *In the Matter of the Appeal of Crocker National Corporation, Before the State Board of Equalization of the State of California*, No. 82A-1785-DB. (61a) In both of these cases it was held that the State was constrained by the banking laws and had to give cognition thereto for tax purposes.

There is no requirement for use of such dual standard in the statute and the use thereof by Finance is irrational, unreasonable and invidious. It permits a bank with its principal office and duly licensed branches in California and a branch in Nassau, Bahamas, to maintain an office in New York City at which its personnel perform all of the services for the Nassau branch that SNB performed for its Nassau branch, and not be subject to the Finance Tax since such bank would not be "doing a banking business" at such office within the City, as determined under the banking laws. Thus, two banks would be performing the very same activities in New York City, and one bank would not be permitted to allocate the income of its Nassau branch outside of the City for purposes of the Finance Tax and the other bank would not even be subject to the Finance Tax let alone be required to allocate any part of the income of such branch to the City.[11]

2. *The Dual Standard violates the Equal Protection Clause.*

A state may make different classifications for the purposes of legislation, under the Equal Protection Clause of the Fourteenth Amendment, "But the classification must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike." *F.S. Royster Guano Company v. Commonwealth of Virginia*, 453 U.S. 412, 415 (1920).

More recently, in *United States Railroad Retirement Board v. Fritz*, 449 U.S. 166, 176 (1980), this Court applied the rational and not invidious standard of *Jefferson v. Hackney, Commissioner of Public Welfare*, 406 U.S. 535, 546 (1972). In applying the rational basis standard, the inquiry is whether the classification is rationally related to the achievement of the purposes of the statute. Inasmuch as the purpose of a tax statute is to raise

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[11] It is to be noted that such bank would also exclude the Nassau branch from the base for the California tax under the laws of that State.

revenue and a state can impose its tax on a corporation conducting activities within the state,[12] it would seem to be irrational and invidious to interpret a statute to exclude certain banks from tax and create a tax advantage for a bank with all of its banking branches outside of the City over one with a banking branch within the City. Accordingly, the interpretation of the statute made by Finance is invalid under the Equal Protection Clause of the Fourteenth Amendment.

3. *The denial of an allocation for the income of SNB's Nassau branch subjected the income thereof to the risk of multiple taxation.*

The Nassau branch of SNB was an instrumentality of foreign commerce. It was regularly conducting a banking business outside of the United States and its taxable income was also from sources outside thereof. Despite this, Finance, in complete derogation of the Federal, State and Bahamian laws, denied an allocation for the income of such branch for purpose of the Financial Tax.

When a state seeks to tax the instrumentalities of foreign commerce, two considerations under the Commerce Clause, come into play, namely, the enhanced risk of multiple taxation and a state tax on such instrumentalities may impair Federal uniformity in an area where it is essential. *Japan Line Ltd. v. County of Los Angeles*, 441 U.S. 434, 446 (1979). A state tax on international commerce is not an impermissible burden thereon providing there is a substantial nexus with the taxing state and there is a fair apportionment. *Complete Auto Transit, Inc.*, supra, at page 279. Denial of the allocation of the income of SNB's Nassau branch by Finance subjects such income to the risk of multiple taxation which is in violation of the Constitution. "Interstate [foreign] commerce would be subject to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids. We have repeatedly held that such a tax is a regulation of, and a burden upon, interstate commerce prohibited by Article 1, §8 of the Constitution." *J.D. Adams Manufacturing Co. v. Storen*, 304 U.S. 307, 311 (1938)

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[12] *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)

4. *The mere risk of multiple taxation violates the Commerce Clause.*

It is the mere *risk* of multiple taxation that invalidates a tax. There does not have to be actual multiple taxation. In *J.D. Adams Manufacturing Co.*, supra, this Court invalidated the tax imposed on a company engaged in interstate and foreign commerce when, in fact, there was no showing that such company was subject to multiple taxation. This was also indicated in *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425 (1980), wherein the Court stated, at page 444, "Inasmuch as New York does not presently tax the dividends in question, actual multiple taxation is not demonstrated on this record . . . We agree with Mobil that *the constitutionality of a Vermont tax should not depend on the vagaries of New York tax policy.*" (Emphasis supplied)

Finance, in imposing the Financial Tax on an instrumentality of foreign commerce has prevented this Nation from "speaking with one voice" in regulating foreign trade.[13] "In international relations and with respect to foreign intercourse and trade, the people of the United States act through a single government with unified and adequate national power." *Board of Trustees v. United States*, 289 U.S. 48, 59 (1933).

SNB was engaged in international commerce through its branch in Nassau, Bahamas. Although the Bahamas did not impose a tax on the income of such branch, the constitutionality of the denial of the right to allocate the income thereof, should not depend on the "vagaries" of Bahamian tax policy. Thus, Finance's determination violates the Commerce Clause, (Art. I, §8, Cl. 3), of the United States Constitution.

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[13] The need to "speak with one voice" is emphasized by the inconsistency of the States in this matter. The States of California and Washington permitted an allocation for a Nassau branch similar to the branch of SNB.

CONCLUSION

The issues involved herein involve many banks since New York City is a banking center. Furthermore, there is a very fundamental issue involved relating to this Nation "speaking with one voice" in international affairs, particularly when there is an inconsistency as between the various states on the taxation of an instrumentality of a foreign jurisdiction. The intermediate State appellate court did not consider that the matter warranted discussion; and the State's highest court did not view the matter worthy of its attention.

For the foregoing reasons, the Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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January 8, 1988

APPENDIX

Statutory Provisions

New York State Enabling Legislation

CITY CORPORATE BUSINESS AND CITY UNINCORPORATED BUSINESS INCOME TAX

Laws 1966, Chapter 772

Effective July 1, 1966.

AN ACT to enable any city having a population of one million or more to raise tax revenue by authorizing the imposition of taxes on general, financial, insurance and transportation corporations and on unincorporated business to provide for the administration and review of such new taxes, to provide for the suspension of any tax on gross income of conduit companies imposed by such city and for the suspension and repeal of any general business and financial tax imposed by any such city, to amend the tax law in relation to authorizing an increase in the rates of tax which such city may impose on utilities and vendors of utility services, and to repeal article two-B of the general city law, authorizing the imposition of a general business and financial tax by such city.

The People of the State of New York, represented in Senate and Assembly, do enact as follows:

Section 1. [Authorization of tax]. Notwithstanding any other provision of law to the contrary, any city having a population of one million or more, acting through its local legislative body, is hereby authorized and empowered to adopt and amend local laws imposing for any such city taxes on general corporations, financial corporations, insurance corporations and transportation corporations. The terms of such local laws shall be, substantially, as follows except that the appendix in such local laws may be amended for the purpose of conforming it with the United States internal revenue code or other federal laws relating to taxation as presently in effect or as they may be amended:

City Business Tax

Model Local Law

* * *

PART III—FINANCIAL CORPORATION TAX

SUBPART 1—TAX ON STATE BANKS, TRUST COMPANIES FINANCIAL CORPORATIONS AND SAVINGS AND LOAN ASSOCIATIONS

§11. Definitions

When used in ~~this~~ subpart:

1. The term "financial corporation" means every corporation doing a banking business as defined in this section, other than a national banking association, a trust company all of the capital stock of which is owned by not less than twenty savings banks organized under a law of this state, or a corporation taxable under part two of this title, and shall include the mortgage facilities corporation created by chapter five hundred sixty-four of the laws of nineteen hundred fifty-six.

* * * * *

4. The words "doing a banking business" means doing such business as a corporation may be created to do under articles three, five, five-a, six and seven of the banking law, or doing any business which a corporation is authorized by such articles to do.

* * * * *

5. The words "foreign banker doing a banking business" in the city, include every foreign corporation doing a banking business in the city, except a national banking association.

* * * * *

The Administrative Code of City of New York

New York City Financial Corporation Tax

§R46-37.1, Imposition of tax. – (a) For the privilege of doing business in the city in a corporate or organized capacity, a tax, computed under section R46-37.5, is hereby annually imposed on every banking corporation for each of its taxable years, or any part thereof, beginning on or after January first, nineteen hundred seventy-three.

* * * * * * * * * * *

§R46-37.2 *Banking Corporation defined; exempt corporations*–

(a) For the purpose of this subpart, a banking corporation means:

* * * * * * * * * * *

(3) every national banking association organized under the authority of the United States which is doing a banking business in the City.

* * * * * * * * * * *

(b) Banking business defined. The words "banking business" as used in this section mean such business as a corporation or association may be created to do under articles three, five, five-a, six, seven and ten of the banking law or any business which a corporation or association is authorized by such articles to do. However, with respect to a national banking association organized under the authority of the United States, a federal savings and loan association or a production credit association, the words "banking business" as used in this section mean such business as a national banking association, federal savings and loan association or production credit association, respectively, may be created to do or is authorized to do under the laws of the United States or this state.

* * * * * * * * * * *

The Administrative Code of the City of New York (continued)

§R46-37.4 *Allocation of entire net income.* — If the taxpayer's entire net income is derived from business carried on both within and without the city, the portion thereof which is derived from business carried on within the city shall be allocated under rules and regulations prescribed by the finance administrator.

Regulations Promulgated by Commissioner of Finance

Reg. §2.1 *Allocation of Income.* (a) The New York City Financial Corporation Tax, Title R, Part III, Chapter 46, New York City Administrative Code, is imposed upon that proportion of net income which is derived from business carried on within New York City.

A corporation or association which maintains an office or place of business within the City, and not elsewhere, is taxable on all of its net income. A corporation or association which is doing business or carries on its business through offices or branches maintained both within the City and without the City must allocate its net income as provided in these regulations.

(b) Definitions of "Doing Business" and of "Business Carried On." — A corporation or association is regarded as "doing business" or "carrying on business" within or without the City when it occupies, has or maintains an office, agency or branch where its functions are systematically and regularly carried on.

In order to require an allocation of the income from business carried on within or without New York City, it is not necessary that the branch or agency maintained within or without the City conduct all functions of the banking business of the corporation or association. It is sufficient if the branch or office conducts some of the functions with which the corporation or association is authorized to exercise regularly and with a fair measure of permanency and continuity.

(c) Allocation Where Business is Carried on Both Within and Without the City – (1) A corporation or association doing business or carrying on business both within and without the City which keeps accounts of the gross income and deductions of each office or branch, which in the opinion of the Finance Administrator, accurately reflect the income from business carried on within the City of each office or branch, may report as its net income subject to tax the net income derived from the offices or branches maintained within the City. In all cases, however, the taxpayer must report the gross and net income of the corporation or association from all business carried on within and without New York City.

* * * * * * * * * * *

New York Tax Statutes
Franchise Tax On Banking Corporations

§1451. Imposition of tax

(a) For the privilege of exercising its franchise or doing business in this state in a corporate or organized capacity, a tax, computed under section fourteen hundred fifty five, is hereby annually imposed on every banking corporation for each of its taxable years, or any part thereof, beginning on or after January first, nineteen hundred seventy-three.

§1452. Banking corporation defined; exempt corporations

(a) For the purpose of this article, banking corporation means:

* * * * * * * * * * *

(3) every national banking association organized under the authority of the United States which is doing a banking business in this state;

* * * * * * * * * * *

(b) Banking business defined. The words "banking business" as used in this section mean such business as a corporation or association may be created to do under articles three, three-b, five, five-a, six and ten of the banking law or any business which a corporation or association is authorized by such articles to do. However, with respect to a national banking association organized under the authority of the United States, a federal savings bank, a federal savings and loan association or a production credit association, the words "banking business" as used in this section mean such business as a national banking association, federal savings bank, federal savings and loan association or production credit association, respectively, may be created to do or is authorized to do under the laws of the United States or this state. The words "banking business" as used in this section shall also mean such business as any corporation or association organized under the authority of the United States has authority to do which is substantially similar to the business which a corporation or association may be created to do under articles three, three-b, five, five-a, six and ten of the banking law or any business which a corporation or association is authorized by such articles to do.

* * * * * * * * * * *

§1454. *Allocation of entire net income*

If the taxpayer's entire net income is derived from business carried on both within and without the state, the portion thereof which is derived from business carried on within the state shall be allocated under rules and regulations prescribed by the tax commission.

United States Code

Title 12 — Banks and Banking

§36. Branch banks

The conditions upon which a national banking association may retain or establish and operate a branch or branches are the following:

* * * * * * * * * * *

(f) The term "branch" as used in this section shall be held to include any branch bank, branch office, branch agency, additional office, or any branch place of business located in any State or Territory of the United States or in the District of Columbia at which deposits are received, or checks paid, or money lent.

* * * * * * * * * * * *

§222. Federal reserve districts; membership of national banks

[The continental United States, excluding Alaska, shall be divided into not less than eight nor more than twelve districts. Such districts may be readjusted and new districts may from time to time be created by the Board of Governors of the Federal Reserve System, not to exceed twelve in all: Provided, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. Such districts shall be known as Federal Reserve districts, and may be designated by number.]

When the State of Alaska or Hawaii is hereafter admitted to the Union the Federal Reserve districts shall be readjusted by the Board of Governors of the Federal Reserve System in such manner as to include such State. Every national bank in any State shall, upon commencing business or within ninety days after admission into the Union of the State in which it is located, become a member bank of the Federal Reserve System by subscribing and paying for stock in the Federal Reserve bank of its district in accordance with the provisions of this Act and shall thereupon be an insured bank under the Federal Deposit Insurance Act [12 USCS §§ 1811 et seq.], and failure to do so shall subject such bank to the penalty provided by the sixth paragraph of this section [12 USCS § 501a].

* * * * * * * * * * * *

§371b. Rate of interest on time and savings deposits; payment before maturity; waiver of notice of source of withdrawal

The Board of Governors of the Federal Reserve System shall from time to time limit by regulation the rate of interest which may be paid by member banks on time and savings deposits, and shall prescribe different rates for such payment on time and savings deposits having different maturities, or subject to different maturities, or subject to different conditions respecting withdrawal or repayment, or subject to different conditions by reason of different locations, or according to the varying discount rates of member banks in the several Federal Reserve districts. The provisions of this paragraph [this section] shall not apply to any deposit which is payable only at an office of a member bank located outside of the States of the United States and the District of Columbia. During the period commencing on October 15, 1962, and ending on October 15, 1968, the provisions of this paragraph shall not apply to the rate of interest which may be paid by member banks on time deposits of foreign governments, monetary and financial authorities of foreign governments when acting as such, or international financial institutions of which the United States is a member.

Repealed by P.L. 96-221, as of March 1, 1986.

* * * * * * * * * * *

§§461. Definitions, payment of interest, and regulations; reserves against deposits; form of reserves

* * * * * * * * * * *

(b) Every member bank shall maintain reserves against its deposits in such ratios as shall be determined by the affirmative vote of not less than four members of the Board within the following limitations:

* * * * * * * * * * *

§481. Appointment of examiners; examination of national banks; affiliates

The Comptroller of the Currency, with the approval of the Secretary of the Treasury, shall appoint examiners who shall

examine every national bank as often as the Comptroller of the Currency shall deem necessary. The examiner making the examination of any national bank shall have power to make a thorough examination of all the affairs of the bank and in doing so he shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency: Provided, That in making the examination of any national bank the examiners shall include such an examination of the affairs of all of its affiliates other than member banks as shall be necessary to disclose fully the relations between such bank and such affiliate and the effect of such relations upon the affairs of such bank; and in the event of the refusal to give any information required in the course of the examination of any such affiliate, or in the event of the refusal to permit such examination, all the rights, privileges and franchises of the bank shall be subject to forfeiture in accordance with section 2 of the Federal Reserve Act, as amended [12 USCS §§ 141, 222-25, 281-283, 285, 286, 501a, and 502]. The Comptroller of the Currency shall have power, and he is hereby authorized, to publish the report of his examination of any national banking association or affiliate which shall not within one hundred and twenty days after notification of the recommendations or suggestions of the Comptroller, based on said examination, have complied with the same to his satisfaction. Ninety days' notice prior to such publicity shall be given to the bank or affiliate.

The examiner making the examination of any affiliate of a national bank shall have power to make a thorough examination of all the affairs of the affiliate, and in doing so he shall have power to administer oaths and to examine any of the officers, directors, employees, and agents thereof under oath and to make a report of his findings to the Comptroller of the Currency. The expense of examinations of such affiliates may be assessed by the Comptroller of the Currency upon the affiliates examined in proportion to assets or resources held by the affiliates upon the dates of examination of the various affiliates. If any such affiliate shall refuse to pay such expenses or shall fail to

do so within sixty days after the date of such assessment then such expenses may be assessed against the affiliated national bank and, when so assessed, shall be paid by such national bank: Provided, however, That, if the affiliation is with two or more national banks, such expenses may be assessed against, and collected from, any or all of such national banks in such proportions as the Comptroller of the Currency may prescribe. The examiners and assistant examiners making the examination of national banking associations and affiliates thereof herein provided for and the chief examiners, reviewing examiners and other persons whose services may be required in connection with such examinations or the reports thereof, shall be employed by the Comptroller of the Currency with the approval of the Secretary of the Treasury; the employment and compensation of examiners, chief examiners, reviewing examiners, assistant examiners, and of the other employees of the office of the Comptroller of the Currency whose compensation is and shall be paid from assessments on banks or affiliates thereof shall be without regard to the provisions of other laws applicable to officers or employees of the United States. The funds derived from such assessments may be deposits by the Comptroller of the Currency in accordance with the provisions of section 5234 of the Revised Statutes [12 USCS § 192] and shall not be construed to be Government funds or appropriated moneys; and the Comptroller of the Currency is authorized and empowered to prescribe regulations governing the computation and assessment of the expenses of examinations herein provided for and the collection of such assessments from the banks and/or affiliates examined. If any affiliate of a national bank shall refuseto permit an examiner to make an examination of the affiliate or shall refuse to give any information required in the course of any such examination, the national bank with which itis affiliated shall be subject to a penalty of not more than $100 for each day that any such refusal shall continue. Such penalty may be assessed by the Comptroller of the Currency and collected in the same manner as expenses of examinations. The Comptroller of the Currency, upon the request of the Board of Governors of the Federal Reserve System, is authorized to assign examiners

appointed under this section to examine foreign operations of State banks which are members of the Federal Reserve System.

. . . . . .

§601. Authorization; conditions and regulations

Any national banking association possessing a capital and surplus of $1,000,000 or more may file application with the Federal Reserve Board [Board of Governors of the Federal Reserve System] for permission to exercise, upon such conditions and under such regulations as may be prescribed by the said board, the following powers:

> First. To establish branches in foreign countries or dependencies or insular possessions of the United States for the furtherance of the foreign commerce of the United States, and to act if required to do so as fiscal agents of the United States.

. . . . . .

§1813. Definitions

As used in this Act –

. . . . . .

(1) The term "deposit" means–

. . . . . .

(5) such other obligations of a bank as the Board of Directors, after consultation with the Comptroller of the Currency and the Board of Governors of the FederalReserve System, shall find and prescribe by regulation to be deposit liabilities by general usage, except that the following shall not be a deposit for any of the purposes of this Act or be included as part of the total deposits or of an insured deposit:

(A) any obligation of a bank which is payable only at an office of such bank located outside of the States of the United States, the District of Columbia, Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, and the Virgin Islands; and

(B) any international banking facility deposit, including an international banking facility time deposit, as such term is from time to time defined by the Board of Governors of the Federal Reserve System in regulation D or any successor regulation issued by the Board of Governors of the Federal Reserve System.

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§1814. Insured Banks

(b) Certificate of Comptroller of Currency authorizing transaction of banking business. Every national member bank which is authorized to commence or resume the business of banking, and which is engaged in the business of receiving deposits other than trust funds as herein defined, and every such national nonmember bank which becomes a member of the Federal Reserve System, and every State Bank which is converted into a national member bank or which becomes a member of the Federal Reserve System, and which is engaged in the business of receiving deposits, other than trust funds as herein defined, shall be an insured bank from the time it is authorized to commence or resume business or becomes a member of the Federal Reserve System. The certificate herein prescribed shall be issued to the Corporation by the Comptroller of the Currency in the case of such national member bank, or by the Board of Governors of the Federal Reserve System in the case of such State member bank: Provided, That in the case of an insured bank which is admitted to membership in the Federal Reserve System or an insured State bank which is converted into a national member bank, such certificate shall not be required, and the bank shall continue as an insured bank. Such certificate shall state that the bank is authorized to transact the business of banking in the case of a national member bank, or is a member of the Federal Reserve System in the case of a State member bank,

and that consideration has been given to the factors enumerated in section 6 [12 USCS §1816]. A State bank, resulting from the conversion of an insured national bank, shall continue as an insured bank. A State bank, resulting from the merger or consolidation of insured banks, or from the merger or consolidation of a noninsured bank or institution with an insured State bank, shall continue as an insured bank.

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United States Code

Title 26 – Internal Revenue Code –

§861. Income from sources within the United States.

(a) Gross income from sources within United States. The following items of gross income shall be treated as income from sources within the United States:

(1) Interest. Interest from the United States, any Territory, any political subdivision of a Territory, or the District of Columbia, and interest on bonds, notes, or other interest-bearing obligations of residents, corporate or otherwise, not incuding –

• • • • • • • • • • •

(C) interest received from a foreign corporation (other than interest paid or credited by a domestic branch of a foreign corporation, if such branch is engaged in the commercial banking business), when it is shown to the satisfaction of the Secretary or his delegate that less than 50 percent of the gross income from all sources of such foreign corporation for the 3-year period ending with the close of its taxable year preceding the payment of such interest (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States,

(D) in the case of interest received from a foreign corporation (other than interest paid or credited by a domestic branch

of a foreign corporation, if such branch is engaged in the commercial banking business), 50 percent or more of the gross income of which from all sources for the 3-year period ending with the close of its taxable year preceding the payment of such interest (or for such part of such period as the corporation has been in existence) was effectively connected with the conduct of a trade or business within the United States, an amount of such interest which bears the same ratio to such interest as the gross income of such foreign corporation for such period which was not effectively connected with the conduct of a trade or business within the United States bears to its gross income from all sources.

* * * * * * * * * * *

(F) interest –

(i) on deposits with a foreign branch of a domestic corporation or a domestic partnership if such branch is engaged in the commercial banking business, and

(ii) on amounts satisfying the requirements of paragraph (2) of subsection (c) which are paid by a foreign branch of a domestic corporation or a domestic partnership,

* * * * * * * * * * *

§862. *Income from sources without the United States.*

(a) Gross income from sources without United States. The following items of gross income shall be treated as income from sources without the United States:

(1) interest other than that derived from sources within the United States as provided in section 861(a)(1);

* * * * * * * * * * *

§901. *Taxes of foreign countries and of possessions of United States.*

(a) Allowance of credit. If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall,

subject to the applicable limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) plus, in the case of a corporation, the taxes deemed to have been paid under sections 902 and 960. Such choice for any taxable year may be made or changed at any time before the expiration of the period prescribed for making a claim for credit or refund of the tax imposed by section 56 (relating to minimum tax for tax preferences), against the tax imposed by section 531 (relating to the tax on accumulated earnings), against the additional tax imposed for the taxable year under section 1333 (relating to war loss recoveries) or under section 1351 (relating to recoveries of foreign expropriation losses), or against the personal holding company tax imposed by section 541.

* * * * * * * * * * *

Code of Federal Regulations

Title 12 – Banks and Banking

PART 204 – RESERVE REQUIREMENTS OF DEPOSITORY INSTITUTIONS

§204.1 Authority, purpose and scope.

(a) Authority. This part is issued under the authority of section 9 (12 U.S.C. 461 et seq.) and other provisions of the Federal Reserve Act and of section 7 of the International Banking Act of 1978 (12 U.S.C. 3105).

(b) Purpose. This part relates to reserves that depository institutions are required to maintain for the purpose of facilitating the implementation of monetary policy by the Federal Reserve System.

(c) Scope. (1) The following depository institutions are required to maintain reserves in accordance with this part:

(i) Any insured bank as defined in Section 3 of the Federal Deposit Insurance Act (12 U.S.C. 1813 (h)) or any Bank that is eligible to apply to become an insured bank under such Act (12 U.S.C. 1815);

* * * * * * * * * * *

(5) The provisions of this part do not apply to any deposit that is payable only at an office located outside the United States.

* * * * * * * * * * *

PART 217 – INTEREST ON DEPOSITS

§217.0 Scope of Part.

(a) This regulation is issued under authority of provisions of section 19 of the Federal Reserve Act which, together with related provisions of law, are cited in the note preceding this section.

(b) This part relates to the payment of deposits and interest thereon by member banks of the Federal Reserve System and not to the computation and maintenance of the reserves which member banks are required to maintain against deposits. The rules concerning reserves of member banks are contained in Part 204 of this chapter.

* * * * * * * * * * *

(d) The provisions of this part do not apply to any deposit that is payable only at an office located outside of the States of the United States and the District of Columbia of a member bank or of a foreign bank.

* * * * * * * * * * *

DECISION OF THE NEW YORK CITY
DEPARTMENT OF FINANCE

THE CITY OF NEW YORK
DEPARTMENT OF FINANCE
BUREAU OF HEARINGS
225 BROADWAY
NEW YORK, N.Y. 10007

CITY OF NEW YORK FHD (8) - F.C. - 7/84 (0-0-0)
DEPARTMENT OF FINANCE Financial Corporation Tax
July 24, 1984

In the Matter of the Petition

of

STERLING BANCORP DECISION

for Redetermination of a Deficiency of Financial Corporation Tax under Title R of Chapter 46 of the Administrative Code of the City of New York for tax years ending December 31, 1979, 1980 and 1981.

Petitioner, Sterling Bancorp, 540 Madison Avenue, New York, New York 10022, filed a petition for redetermination of a deficiency of financial corporation tax under Title R of Chapter 46 of the Administrative Code of the City of New York for the tax years ending December 31, 1979, December 31, 1980 and December 31, 1981.

A hearing was held before Stanley C. Nosol, Hearing Officer, at the offices of the New York City Department of Finance, 225 Broadway, New York, New York on February 21, 1984, February 22, 1984 and February 24, 1984. Petitioner appeared by Hutton & Solomon (Roy F. Hutton, Esq., Stephen L. Solomon, Esq. and Richard Agins, Esq. of counsel). The Department of Finance appeared by Maria T. Jones, Esq. (Ellen Gursky, Esq. and Ramon Cintron, Esq. of counsel).

ISSUE

Whether the Department of Finance properly disallowed Sterling National Bank & Trust Company of New York's allocation of a portion of its net income outside New York City.

FINDINGS OF FACT

1. Petitioner, a bank holding corporation with its principal office located at 540 Madison Avenue in New York City filed consolidated New York City financial corporation tax returns for the taxable years ended December 31, 1979, December 31, 1980 and December 31, 1981, with certain of its wholly-owned subsidiaries, including Sterling National Bank & Trust Company of New York ("SNB").

2. SNB, on its financial corporation tax return for the six month period ended December 31, 1979 had not, pursuant to section R46-37.4 of the Administrative Code, allocated any of its income and expenses outside the City.

3. SNB on its financial corporation tax returns for the taxable years ended December 31, 1980 and December 31, 1981 had allocated its net income in the respective amounts of $8,813,000.00 and $11,638,000.00 outside the City.

4. To arrive at the $8,813,000.00 net income which SNB had allocated outside the City for tax year ended December 31, 1980, SNB had allocated $14,293,000.00 in interest income outside the City and had deducted therefrom $5,464,000.00 in interest expense and $16,000.00 in operating expenses which it had also allocated outside the City.

5. To arrive at the $11,638,000.00 net income which SNB had allocated outside the City for tax year ended December 31, 1981, SNB had allocated $21,578,000.00 in interest income outside the City and had deducted therefrom $9,921,000.00 in interest expense and $19,000.00 in operating expenses which it had also allocated outside the City.

6. On July 1, 1983, the Department of Finance issued to petitioner a notice of determination asserting a financial corporation tax deficiency as follows:

Tax Period	*Principal*	*Pen./Int.*	*Total*
7/1/79–12/31/79	$ (20,256.00)	$ (7,291.00)	$ (27,547.00)
1/1/80–12/31/80	48,362.00	13,287.00	61,649.00
1/1/81–12/31/81	1,378,810.00	286,366.00	1,665,176.00
	$1,406,916.00	$ 292,362.00	$1,699,278.00

7. In arriving at the deficiencies for the tax years ended December 31, 1980 and December 31, 1981, the Department of Finance determined that the Nassau, Bahamas branch claimed by SNB was not a branch where its functions are systematically and regularly carried on within the meaning of financial corporation tax regulation sections 2-1(a) and 2-1(b). Accordingly, it added back the net income allocated by SNB to its Nassau, Bahamas branch in the respective amounts of $8,813,000.00 and $11,638,000.00 which SNB had excluded from its net income subject to tax. Other adjustments made by the Department of Finance involved the add-back of intercorporate dividends paid to it by its subsidiaries which SNB had eliminated from its entire net income for all tax years in issue as well as the elimination of "Acretion of Bond Discount" which SNB had erroneously add-back for tax years ended December 31, 1979 and December 31, 1980.

8. It is the petitioner's contention that, based upon sections R46-37.1, R46-37.2(a) and R46-37.2(b) of the Administrative Code, the only type of business that a corporation subject to the financial corporation tax can do is a banking business as determined under the Federal or State Banking Laws. Therefore, it is contended that the determination whether or not SNB's Nassau branch is a branch for purposes of the financial corporation tax must be made by reference to the Federal and State Banking Laws.

9. The Department of Finance, by letter dated September 23, 1983, notified the petitioner that it had been decided not

to assert any deficiency based on the failure of petitioner to pay any tax on the intercorporate dividends paid to it by its subsidiaries who filed with it on a New York City consolidated basis. As a result the deficiency asserted in the notice of determination, dated July 1, 1983, was revised as follows:

Tax Period	*Principal*	*Interest*	*Total*
7/1/79–12/31/79	$ (41,861.00)	$ (14,727.00)	$ (56,588.00)
1/1/80–12/31/80	(9,418.00)	(2,511.00)	(11,929.00)
1/1/81–12/31/81	1,315,708.00	248,097.00	1,563,805.00
	$1,264,429.00	$ 230,859.00	$1,495,288.00

10. SNB, is a Federally chartered bank (national bank) with its principal office located at 540 Madison Avenue, New York, New York.

11. On October 18, 1968, SNB filed an application with the Board of Governors of the Federal Reserve System to open a branch in Nassau, Bahamas. According to SNB's application, the primary reason for the establishment of a Bahamas branch was to participate in the Eurodollar market, an activity which, under Federal Reserve Board regulation, could not be conducted from its New York office. Said application further stated in part as follows:

> "The Voluntary Foreign Credit Restraint Program and the Interest Equalization Tax have provided an incentive for the large banks to open foreign branches to tap the Eurodollar markets. Faced with the necessity of curbing lending to foreigners from home offices, a number of large American banks have come to view the overseas branch as an essential adjunct to their banks, not only for the long-run profits from the branch's operations per se, but also in order to service adequately the needs of multinational clients (excerpted from 1967 Annual Report of the Comptroller of the Currency).
>
> It is not feasible for the Bank to emulate the large banks by the opening of a London or other foreign

branch because of the near prohibitive costs involved in relation to the capital and earnings of the Bank. A Bahamas branch seems to be the ideal vehicle for this Bank to acquire foreign dollar deposits. The ability to attract domestic deposits both nationally and locally is also restricted in competition with the large banks which have widely scattered facilities and branches, thereby attracting deposits from all sources.

Approval is sought for the opening of a Bahamas branch of the Bank to be serviced under an agreement with the World Banking Corporation Limited (W.B.C. Ltd.) (Details of arrangement in Exhibit "C"). It is estimated that the entire net cost of such operation would not exceed $20,000 per year including the annual servicing fee of $15,000 to W.B.C. Ltd. The agreement with W.B.C. Ltd. can be terminated at anytime upon reasonable notice."

12. On February 20, 1969, the Board of Governors of the Federal Reserve System granted SNB permission to establish a branch in Nassau, Bahamas. Shortly thereafter, SNB was duly licensed by the Bahamian Ministry of Finance to open a branch in Nassau, Bahamas. On May 26, SNB notified the Federal Reserve Board of Governors that a branch office would be opened on June 2, 1969 at 50 Shirley Street in Nassau.

13. In granting its permission, the Federal Reserve Board declared that it was to be understood that there was to be no contact with the local public at the branch, and that its quarters, staff and bookkeeping could, at least in part, be supplied under contract by another party. In addition, the Federal Reserve Board directed that it be notified of any modification in the branch's methods of operations, including changes in any contracts under which services were supplied to the branch.

14. The branch established by SNB in Nassau was to be serviced under an agreement with the World Banking Corporation Limited (W.B.C.), by the terms of which WBC was to lease to it a portion of the premises which WBC occupied in a

building at 50 Shirley Street, Nassau, Bahamas. The agreement provided that WBC was to furnish SNB with a "small enclosed segregated office" in the premises. The agreement also provided that WBC was to provide SNB with a branch manager and an assistant branch manager either from its own staff or from qualified local residents outside of the bank. These persons were to have separate contracts with SNB. However, the salaries, if any, paid to these individuals were to be turned over to WBC. Pursuant to the agreement with WBC, a branch manager and an assistant branch manager were designated, and they were advised by separate letters, the terms of which they each accepted, that "all transactions will be originated by our New York office and that you shall perform such duties and services as our New York office shall direct and as may be reasonably required in the operation of our Nassau branch.

15. During the tax years in question SNB claimed total expenses of $10,000.00 per year, in connection with the operation of its Nassau, Bahamas branch, which included the cost of the space and services provided by WBC as well as the salaries of two part time employees.

16. All transactions of SNB's Nassau branch originate and occur in New York City. The records of the Nassau branch are kept in New York City. All decisions regarding the investment of the funds reported as Nassau branch funds are made by the investment committee located in New York City. The assets attributed to the Nassau branch are all deposited in time deposits in foreign banks, the foreign branches of domestic banks or the International Banking Facilities of other banks.

17. During the tax years in issue, SNB filed the requisite periodic reports with the Federal Reserve Bank of New York, the Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency which showed the deposits attributed to SNB's Nassau branch, but excluded these deposits from the deposits subject to the reserve requirements of the Federal Reserve System and FDIC coverage. The Federal Reserve Bank of New York, the FDIC and The Office of the Comptroller of the Currency have accepted these reports as filed.

18. For tax year ended December 31, 1980, the income before taxes of SNB's foreign banking operations was listed in the footnotes to the financial statements contained in the Annual Report and SEC Form 10-K of petitioner for that year as follows:

International:	
Western Hemisphere	$7,505,000.00
Europe	1,308,000.00
	$8,813,000.00

19. For tax year ended December 31, 1981, the income before taxes of SNB's foreign banking operations was listed in the footnotes to the financial statements contained in SEC Form 10-K of petitioner for that year as follows:

International:	
Western Hemisphere	$9,978,000.00
Europe	1,660,000.00
	$11,638,000.00

20. The chief investigator of the Department of Finance's Enforcement Division visited SNB's Bahamas branch in January, 1983 (a date subsequent to the audit period). His visit disclosed the following:

a) that SNB had a listing in the Nassau, Bahamas telephone directory for premises at 50 Shirley Street, Nassau, Bahamas;

b) that SNB shared the telephone with some other corporations;

c) that SNB shared office space at 50 Shirley Street, Nassau, Bahamas, consisting of a room approximately 20 x 40 feet, with approximately forty-six other corporations, most of which appeared to be banks;

d) that said office contained three to four desks;

e) that at the time of his visit to said office, which was in midday on a business work day, there was only one female employee on the premises;

f) that said premises had neither teller windows or any name plates on the desks indicating loan officers; and

g) that banking hours were not listed on the door to said office.

21. The petitioner did not produce any witnesses who had personal knowledge regarding the daily operations of SNB's Nassau branch. Nor did it offer any evidence to show that there had been any modification in said branch's methods of operations since its establishment in 1969.

22. As an additional contention, petitioner contends that, under section R46-37.4 of the Administrative Code, the Finance Administrator (now the Commissioner of Finance) could only issue rules and regulations with respect to the allocation of income derived from business carried on within the City and, therefore, he had no authority to issue rules and regulations concerning the allocation of income which petitioner claims is derived from business activities carried on by SNB outside the City.

CONCLUSIONS OF LAW

A. That the New York City financial corporation tax is imposed pursuant to section R46-37.1 of the Administrative Code which provides as follows:

> "Imposition of tax.—(a) For the privilege of doing business in the city in a corporate or organized capacity, a tax, computed under section R46-37.5, is hereby annually imposed on every *banking corporation* for each of its taxable years, or any part thereof, beginning on or after January first, nineteen hundred seventy-three." (Emphasis added).

B. That section R46-37.2(a) of the Administrative Code, which defines the term *banking corporation*, provides in pertinent part as follows:

"(a) For the purposes of this subpart, a banking corporation means:

(3) every national banking association organized under the authority of the United States which is doing a *banking business* in the city." (Emphasis added).

C. That section R46-37.2(b) of the Administrative Code defines a *banking business* as follows:

"(b) Banking business defined. The words "banking business" as used in this section mean such business as a corporation or association may be created to do under articles three, five, five-a, six, seven and ten of the banking law or any business which a corporation or association is authorized by such articles to do. However, with respect to a national banking association organized under the authority of the United States, a federal savings and loan association or a production credit association, the words "banking business" as used in this section mean such business as a national banking association, federal savings and loan association or production credit association, respectively, may be created to do or is *authorized to do under the laws of the United States or this state.*" (Emphasis added).

D. That section R46-37.4 of the Administrative Code provides as follows:

"If the taxpayer's entire net income is derived from business carried on both within and without the city, the portion thereof which is derived from business carried on within the city shall be allocated under rules and regulations prescribed by the finance administrator."

E. That under the regulations promulgated pursuant to the financial corporation tax in effect prior to 1973 – which are still relevant – a banking corporation is permitted to allocate its income if it is doing business or carrying on business through

offices and branches maintained both within and without the City, but is not permitted to allocate if its only office or place of business is within the City. (Regulation section 2-1(a)).

F. That under section 2-1(b) of these regulations the terms "Doing Business" and of "Business Carried On" are defined as follows:

> "Definitions of 'Doing Business' and of 'Business Carried On'. — A corporation or association is regarded as 'doing business' or 'carrying on business' within or without the City when it occupies, has or maintains an office, agency or branch where its functions are systematically and regularly carried on.
>
> In order to require an allocation of the income from business carried on within or without New York City, it is not necessary that the branch or agency maintained within or without the City conduct all the functions of the corporation or association. It is sufficient if the branch or office conducts some of the functions which the corporation or association is authorized to exercise regularly and with a fair measure of permanency and continuity."

G. That references in sections R46-37.2(a) and R46-37.2(b) of the Administrative Code to the Federal and State Banking Laws are merely to determine whether a corporation is subject to the financial corporation tax, pursuant to section R46-37.1(a).

H. That the determination of whether SNB is doing business or carrying on business at a branch outside the City, so as to enable it to allocate its income pursuant to section R46-37.4 of the Administrataive Code, is to be made by reference to regulation section 2-1(b) issued by the Finance Administrator (now the Commissioner of Finance) and not by reference to the Federal and State Banking Laws.

I. That, although SNB's Nassau facility may qualify as a branch under Federal and State Banking Laws (including the requirements of the Federal Reserve System and Federal Deposit

Insurance Corporation (FDIC)), it is not a branch, office or agency where functions are systematically and regularly carried on within the meaning and intent of financial corporation tax regulation section 2-1(b).

J. That, pursuant to section R46-70.0.5 of the Administrative Code, petitioner had the burden of proof to overcome the deficiency assessment and to show that SNB had the right to allocate a portion of its net income outside the City.

K. That petitioner did not sustain its burden of proof to show that SNB had the right to allocate a portion of its net income outside the City pursuant to section R46-37.4 of the Administrative Code and regulation sections 2-1(a) and 2-1(b). Petitioner offered no evidence to show that SNB maintained a branch, office or agency outside the City where its functions were systematically and regularly carried on within the meaning of the aforementioned regulations. All transactions of SNB's Nassau branch originate and occur in New York City, including all decisions regarding the investment of funds reported as Nassau branch funds. (See Finding of Fact "16" supra). Moreover, the Nassau branch is not even permitted to deal with the local public. (See Finding of Fact "13" supra).

L. That SNB's Nassau branch in the Bahamas is a legal device, set up for the sole purpose of enabling it to participate in the Eurodollar market; and wholly lacking the attributes of a *bona fide* bank branch, office or agency, where its functions are systematically and regularly carried on. (Emphasis added).

M. That for the reasons stated in Conclusions of Law "H", "I", "K" and "L" supra, the Department of Finance properly disallowed SNB's allocation of a portion of its net income outside New York City.

N. That petitioner's contention that the Finance Administrator (now Commissioner of Finance) had no legislative authority to issue rules and regulations as to the allocation of the income of SNB's Nassau, Bahamas branch is without merit since it has been determined that all activity from which the income in question was derived took place within New York City.

O. That the petition of Sterling Bancorp is denied and the Notice of Determination issued on July 1, 1983, as modified by Findings of Fact "9" supra, is sustained.

DATED: New York, New York

/s/Robert Kraut
Robert Kraut
Director, Hearings Bureau

/dh

ORDER OF THE APPELLATE DIVISION

At a term of the Appellate Division of the Supreme Court held in and for the First Judicial Department in the County of New York, on March 10, 1987

Present—Hon. Leonard H. Sandler, Justice Presiding
John Carro
Sidney H. Asch
Ernst H. Rosenberger
Richard W. Wallach, Justices.

---------- X

Application of Sterling Bancorp,

Petitioner,

For a Judgment Pursuant to Article 78 of the CPLR,

—against— 29432

New York City Department of Finance and
Philip R. Michael, Commissioner of Finance,

Respondents.

---------- X

The above-named petitioner having moved at Special Term of the Supreme Court, New York County, pursuant to Article 78 of the Civil Practice Law and Rules, for a review by the court of a determination of the respondents dated July 25, 1984,

And this proceeding having been transferred by order of said court, entered on July 5, 1985 (Helen Freedman, J.), to this Court for review and determination,

And said proceeding having duly come on to be heard before this Court and having been argued by Richard C. Agins, Myron Weinberg and Stephen L. Solomon of counsel for the petitioner, and by Joseph V. Hamilton, Jr., Edith I. Spivack and Glenn Newman of counsel for the respondents; and due deliberation having been had thereon,

It is unanimously ordered that the determination of the respondents be and the same hereby is confirmed, without costs and without disbursements. The clerk is directed to enter judgment in favor of respondents, confirming the determination.

ENTER:

HAROLD J. REYNOLDS

Clerk.

ORDERS OF THE COURT OF APPEALS

State of New York,
Court of Appeals

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the seventh day of July A.D. 1987

Present, HON. SOL WACHTLER, Chief Judge, presiding.

Mo. No. 686 SSD 47

In the Matter of Sterling Bancorp,

Appellant,

vs.

New York City Department of Finance, et al.,

Respondents.

The appellant having filed notice of appeal in the above title and due consideration having been thereupon had, it is

ORDERED, that the appeal be and the same hereby is dismissed without costs, by the Court *sua sponte*, upon the ground that no substantial constitutional question is directly involved. Judge Kaye took no part.

/s/Donald M. Sheraw
Donald M. Sheraw
Clerk of the Court

State of New York,
Court of Appeals

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the twentieth day of October A.D. 1987

Present, HON. SOL WACHTLER, Chief Judge, presiding.

1-10 Mo. No. 968

In the Matter of Sterling Bancorp,

Appellant,

vs.

New York City Department of Finance, et al.,

Respondents.

A motion for leave to appeal to the Court of Appeals in the above cause having been heretofore made upon the part of the appellant herein and papers having been submitted thereon and due deliberation thereupon had, it is

ORDERED, that the said motion be and the same hereby is denied with twenty dollars costs and necessary reproduction disbursements.

Judge Kaye took no part.

/s/Donald M. Sheraw

Donald M. Sheraw
Clerk of the Court

NOTICE OF APPEAL TO THE SUPREME COURT
OF THE UNITED STATES

SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION – FIRST DEPARTMENT

– X

Application of STERLING BANCORP.,

Appellant,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

– against –

New York County
Clerk's Index No.
91682/83

NEW YORK CITY DEPARTMENT OF FINANCE and PHILIP R. MICHAEL, Commissioner of Finance,

Respondents

– X

NOTICE OF APPEAL

Notice is hereby given that Sterling Bancorp, the appellant above-named, hereby appeals to the Supreme Court of the United States from the judgment of the Supreme Court of the State of New York, Appellate Division, First Department (New York County Clerk's Index Number 91682/83), dismissing the petition, entered in a proceeding brought pursuant to Article 78 of the New York Civil Practice Law and Rules proceeding on March 10, 1987, which became a final judgment on October 20, 1987 upon entry of order of the Court of Appeals of the State of New York denying appellant's motion for leave to appeal.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

Dated: New York, New York
December 3, 1987

Yours, etc.

HUTTON & SOLOMON
342 Madison Avenue
New York, New Yokr 10173
(212) 682-5702
Attorneys for Appellant
Sterling Bancorp

TO: Peter L. Zimroth, Esq.
Corporation Counsel
Attorneys for Respondents
100 Church Street
New York, N. Y. 10007

Hon. Harold J. Reynolds
Clerk of the Supreme Court,
Appellate Division
27 Madison Avenue
New York, New York 10010

The Clerk of New York County
60 Centre Street
New York, New York 10007

SUPREME COURT OF THE STATE OF NEW YORK
APPELLATE DIVISION – FIRST DEPARTMENT

– X

Application of STERLING BANCORP.,

Appellant,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

– against –

New York County
Clerk's Index No.
91682/83

NEW YORK CITY DEPARTMENT OF FINANCE and PHILIP R. MICHAEL, Commissioner of Finance,

Respondent.

– X

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
) ss.:
COUNTY OF NEW YORK)

MYRON WEINBERG, being duly sworn deposes and says:

1. I am an attorney duly admitted to practice law before the courts of this state.

2. On December 3, 1987, I served a copy of the within Notice of Appeal to the Supreme Court of the United States upon the office of the Corporation Counsel of the City of New York, 100 Church Street, New York, New York 10007, by placing said Notice of Appeal in a securely wrapped first class postage prepaid envelope addressed to the said office at the aforesaid address, and thereafter deposited name in an official depository under the exclusive care and custody of the United States Postal Service within New York State.

3. All parties required to have been served by the rules of the Supreme Court of the United States have been served with said Notice of Appeal.

/s/Myron Weinberg
MYRON WEINBERG

Sworn to before me this
3rd day of December, 1987

/s/Deborah J. Neal
NOTARY PUBLIC

DEBORAH J. NEAL
Notary Public, State of New York
No. 03-4768256
Qualified in Bronx County
Term Expires July 31, 1988

New York State Department of TAXATION and FINANCE

Taxpayer Services Division
Technical Services Bureau

TSB-A-82(13)C
Corporation Tax
September 21, 1982

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. C810716A

On July 16, 1981 a Petition for Advisory Opinion was received from Lloyds Bank California, 612 Flower Street, Los Angeles, California 90017.

At issue is whether a banking corporation organized under the laws of California would be subject to either the Franchise Tax on Business Corporations imposed under Article 9-A of the Tax Law or the Franchise Tax on Banking Corporations imposed under Article 32 of the Tax Law, as a result of maintaining a representative within the State and of establishing a loan production office in New York City.

Petitioner is a banking corporation chartered and organized under the laws of California. Petitioner's principal place of business and chief executive offices are located in Los Angeles, California.

Petitioner has stationed a representative in New York City and anticipates establishing an office in New York for loan production purposes. The Petitioner's representative is primarily responsible for developing secured and unsecured loans, developing leasing business, and selling other related business services. In the future, the personnel staffing the representative office will originate loans, assemble credit information, make property inspections and appraisals, and perform other services incident to securing loans. All loans and leases, however, will be approved in California, all funds will be disbursed from California and all payments will be due in California.

Section 1451(a) of the Tax Law, contained in Article 32, provides, in pertinent part, for the imposition of a tax on every banking corporation "exercising its franchise or doing business in this state in a corporate or organized capacity . . . ".

Section 1452(a)(2) of the Tax Law defines the term "banking corporation," in pertinent part, to include "every corporation or association organized under the laws of any other state or country which is doing a banking business in this state. . . . "

Section 1452(b) of the Tax Law, in pertinent part, defines the term "banking business" to mean "such business as a corporation or association may be created to do under articles three, three-b, five, five-a, six, seven and ten of the banking law, or any business which a corporation or association is authorized by such articles to do."

Section 200 of the Banking Law, contained in Article 5 thereof, requires that foreign banks be licensed by the Superintendent of Banks before they may transact any banking business in New York, with certain exceptions not germane to the present matter. Supervisory Policy CB 121 of the Banking Department Article 9-A, provides that corporations liable to tax under Article 32 of the Tax Law are not subject to tax under Article 9-A. It has been held that a corporation is to be treated as a single entity for purposes of determining whether it is liable to tax under former section 182 or under Article 9-A of the Tax Law. (Former Section 182 imposed a franchise tax on real estate corporations). *Matter of Central Park Plaza Corp. v. Bates*, 278 App. Div. 607, aff'd 303 N.Y. 694. Recognizing this principle, the State Tax Commission has not sought to treat a foreign banking corporation as taxable under Article 9-A based upon the particular activities conducted in this state only. Accordingly, Petitioner's liability for tax has been effectively ruled upon herein by application of the provisions of Article 32 of the Tax Law. See Letter of Counsel, November 14, 1973.

Dated: September 20, 1982

/s/LOUIS ETLINGER
Deputy Director
Technical Services Bureau

STATE OF WASHINGTON
DEPARTMENT OF REVENUE
OLYMPIA 98504

Before the Department of Revenue of the State of Washington

In the Matter of the Petition for Correction of Assessment and Refund of	DETERMINATION
	No. 76-29
SEATTLE-FIRST NATIONAL BANK	Registration No. J578 049 247
Tax and Accounting Services Division P.O. Box 3586 Seattle, Washington 98124	

TAXPAYER REPRESENTED BY:
John T. Mudge, Vice President
Ivan L. Jacques, Vice President
Douglas D. Schindele, Assistant Vice President
Michael J. Welch, Assistant Vice President
Albert L. McCloskey, Assistant Vice President
C. James Judson, Attorney

DEPARTMENT OF REVENUE REPRESENTED BY
INTERPRETATION AND APPEALS DIVISION:
Don R. McCuiston, Senior Hearing Officer
FIELD OPERATIONS DIVISION:
Oscar Johnson, Assistant Regional Director

DATE AND PLACE OF CONFERENCE: November 14, 1975; Seattle, Washington

FACTS:

The Bank's accounting records have been audited in a primary and supplemental report, dated February 26, 1975 and April 18, 1975 respectively, for the period from January 1, 1972 through December 31, 1973. This audit disclosed a tax and interest deficiency of $465,092.55 and Tax Assessment 85687 was issued for this amount on May 5, 1975. This tax assessment is unpaid at this time.

TAXPAYER'S EXCEPTIONS:

1. Business and occupation tax has been assessed under the Service and Other Activities classification on income derived from financial services participated in by the taxpayer's branch in Nassau, the Bahamas. This branch is operated by the Bank's International Banking Division which is controlled and directed from the Seattle headquarters office. Basically for this reason the audit treats all income of the International Banking Division as earned in Washington and subject to this state's taxing jurisdiction.

On January 21, 1970, permission was received from the Federal Reserve Board and on February 16, 1970, from the Bahamas Finance Ministry, to establish a foreign branch office in Nassau, the Bahamas, subject to payment of an annual Bahamas license fee of $2,000 to $6,300. On February 20, 1970 in accordance with the Bahamas law, the Bank entered into an agreement with Bahamas International Trust Company (BITCO) Nassau, the Bahamas, under which BITCO would provide certain services necessary to the operation of the Nassau branch. The branch commenced business on March 2, 1970 and the annual fee to BITCO has been $11,500 to $14,000. Under terms of the agency agreement, BITCO (1) provides banking and related services as necessary and appropriate, (2) assigns two officers to act on Nassau's behalf, and (3) maintains records and accounts necessary to comply with the United States and Bahamas banking laws. Deposits, loans, agreements and commitments are approved by the taxpayer bank at Seattle, Washington.

Types of customers are (1) foreign governments and their agencies, (2) foreign corporations, financial and non-financial and (3) nonresident affiliates of various United States corporations. There are two main sources of income from Nassau operations: (1) loans and (2) money trading. The International Banking Division's loan committee, located at the taxpayer bank headquarters in Seattle, approves the credit on Nassau loans proposed by the Bank's regional foreign loan officers.

Once the loan officer or deposit trader commits Nassau branch Euro-dollars or Euro-currencies to a transaction with a loan customer or a counter party, he notifies the local Nassau clerk, who is an employee of the Bank's International Banking Division. The clerk's duties are those of compliance in processing the necessary paper work and reports. Detail transactions are mailed to the Nassau branch for entry in the original financial records and various reports are prepared for the branch, loan officers and deposit trader. The Nassau branch was established pursuant to Section 25 of the Federal Reserve Act, 12 U.S.C. Section 601, which authorizes a national banking association possessing a capital and surplus of $1,000,000 or more, "to establish branches in foreign countries . . ." under regulations as may be prescribed by the Board of Governors of the Federal Reserve Board.

The Bank contends that it has a place of business in Nassau. It has complied with the United States and Bahamas laws in the establishment of a branch office. The Bahamas International Trust Company (BITCO) is a registered agent and a name plate bearing the name of SEATTLE-FIRST NATIONAL BANK is displayed on the front of the building. The original records and accounts are maintained in Nassau and the Nassau Bank Account, through which all transactions are cleared, is located at the Irving Trust Company, New York, New York. These activities in accordance with Bahamas law are necessary for the continuation of the Nassau branch and to the services performed for Nassau customers. The Nassau branch performs services for customers that could not be performed at a domestic office or branch. The activities that the Nassau branch does which a domestic office or branch cannot do under regulations promulgated by the federal reserve system are, (1) under Federal Reserve Regulation M, a foreign branch is generally permitted to guarantee customers' debts. A domestic office or branch is clearly prohibited from making guarantees, (2) a foreign branch is exempt from the reserve requirements generally imposed on all member banks by Federal Reserve Regulation D and, (3) pursuant to Federal Reserve Regulation Q a domestic branch is limited on the interest rate it may pay its depositors. The

exemption of the Nassau branch from the reserve requirements of Regulation D and the interest limitations of Regulation Q enables the Nassau branch to make loans without reserve requirements and to pay depositors substantially higher rates of interest than is possible at domestic offices.

The liabilities of the Nassau branch are legally payable only in Nassau and not at any domestic branch of the bank. The Nassau branch income is considered foreign source income for federal income tax purposes as determined by IRC Section 862, and subject to tax limitations per IRC Section 904. The location of the Nassau employees (loan officers and deposit trader) at the Bank's headquarters in Seattle is incidental to the operation of the Nassau branch. They are located at the head office of the Bank primarily because of the availability of direct communication lines to world financial centers, foreign money trading brokers, foreign customers, and domestic banks with the Nassau branch.

On the basis of this explanation, the Bank contends the business and occupation tax has been erroneously assessed under WAC 458-20-193 D and WAC 458-20-194.

2. The business and occupation tax under the Manufacturing classification, as well as Use tax, are assessed on the value of products produced by the Bank as a result of (a) credit card embossing, (b) duplicating, and (c) microfilming.

The Bank explains these activities as follows.

A. Credit Card Embossing. This consists primarily of two functionally distinct steps. A plastic card preprinted with art work and an insignia is fed into a machine which, through heat and pressure, raises letters on the face of the card. The letters indicate the name of the prospective card holder and various identification data concerning his account with the Bank. As the card continues through the machine, a magnetic stripe on the back of the card is fixed with electro magnetic data which represents the card holders code for cash machines purposes. The processing machine reads an input tape and from the

information on that tape both embosses and incodes the cards flowing through the machine. At the end of the process, the cards are inserted in a mailer envelope, together with any advertising materials being used by the Bank, and are sent to the appropriate customer.

B. Duplicating. The Duplicating Department is a facility for the duplicating of an original letter, document, report, bulletin, or other paper guideline necessary for the communication and instruction of employees, officers, and members of the Board of Directors in maintaining and operating the daily flow of business of the Bank. The Department has several functions. It has two magnetic tape selectric typewriters for typing printed material. The typewriters produce a typed original document in finished form. The document can then be reproduced by photocopying or by other methods as directed by the requesting department of the Bank. The Duplicating Department also has light tables for layout of materials to be duplicated. The light tables consist of a sheet of glass behind which is located fluorescent lighting. The lighting enables a worker to determine the proper positioning for materials which are to be introduced onto a sheet of paper.

Once a document is prepared by typing or layout, or if a document is sent down for duplication by another department of the Bank, the Duplicating Department reproduces the document in any of three fashions, depending upon the number of copies required and the specifications of the finished product. The Duplicating Department utilizes an ordinary photocopy machine for some of its duplication. It has a second, high-speed photocopy machine for duplicating larger numbers of photocopies. It has an offset duplicating machine which reproduces written characters from a "paper mat". The mat is produced on a photocopy machine from a standard typewritten or other page. The mat is placed upon the offset duplicating machine and the machine reproduces between 500 and 1,000 copies from that mat. If additional copies are required, additional mats must be made. After duplicating, the department has the capacity to collate and fasten together duplicated copies.

C. Microfilming. The Bank does microfilming of two distinct types. Pursuant to the Bank Secrecy Act, the Bank is required to microfilm and retain as part of internal records all checks in excess of $100 which clear the Bank. Microfilm records must be kept for seven years under the Act. This microfilming takes place at the Bank's computer center in Seattle; smaller regionalized microfilming centers are located in Spokane, Pasco and Wenatchee. The Seattle operation is representative of microfilming activities at these other locations. Checks are sent by messenger from the Western Washington branches of the Bank to the Seattle computer center. A machine called a reader/sorter separates the checks into items which are drawn on the Bank and those which are not drawn on the taxpayer Bank. Nontaxpayer Bank items are shipped out for payment. Items drawn on the Bank are fine sorted according to account number sequence and physically placed in account number sequence by an additional machine. The checks are run through a microfilming machine which photographs the front and back of each check and face cancels each check. The film is developed, marked by date of receipt of the checks, and placed in the Bank's long term files. The checks are held separately for transmission to Bank customers in the monthly statements. The purpose of this microfilming operation is to satisfy the requirements of the Bank Secrecy Act. In addition, the film is very infrequently utilized by the Bank in answering an inquiry of a customer concerning whether an item which has been lost by the customer has in fact been paid by the Bank.

The Bank also does microfilming at each branch of the Bank for security purposes. All items which come across the tellers cages of a particular branch will be microfilmed by that branch in order to protect both the bank and its customers in case there should be a loss of those items during transmission to the computer center or because of a robbery of a branch. The microfilming of teller items is not done on an organized basis; the items are kept on a shorter term basis at the branch and are subsequently destroyed.

The Bank contends these activities do not meet the requirements of RCW 82.04.110 "manufacturer", RCW 82.04.120

"to manufacture", or RCW 82.04.130 "commercial or industrial use". Under these stautory definitions the Bank argues its credit cards are not manufactured items of tangible personal property but rather, that such cards primarily represent intangible rights to various bank services. The embossing process merely results in personalizing these intangible rights. The Bank contends further it does not subject these credit cards to "commercial or industrial use" as that term is defined by RCW 82.04.130 and WAC 458-20-134, as it does not use the cards as a "consumer". The Bank argues additionally that the embossing of credit cards does not result in a "new, different, or useful article of tangible personal property" within the intent of RCW 82.04.120 and WAC 458-20-136, and our attention was directed to Excise Tax Bulletin 213 which provides that an activity is not manufacturing

> . . . if the result achieved does not consist in the making of a new article or giving the article a new use, but rather merely extends the utility already had by the product upon which the activity is being performed.

Finally, regarding the credit cards, the Bank urges that the embossing creates visual images which is not a manufacturing activity under Rule 136 as artists and portrait photographers are listed as examples of activities considered to be nonmanufacturing.

The Bank contends the process of duplicating or photocopying is not manufacturing within the definition of RCW 82.04.120. Manufacturing embraces only activities "of a commercial or industrial nature". The duplicating activities of the Bank are internal to the Bank and are not intended for commercial or industrial purposes. Secondly, the photocopying process does not result in a "new, different or useful substance or article," as emphasized in Excise Tax Bulletin 213. The photocopying process merely extends a utility which paper products intrinsically have—the facility of accepting written communications.

As stated in the above description of the process with respect to the duplicating activities, the Bank contends microfilming is not of a commercial or industrial nature and the process does not result in a new, different, or useful article. Microfilming is performed at the Bank's computer center only because of the specific requirements of the Bank Secrecy Act, and microfilming is performed at branch locations solely because of the security requirements of the Bank and its customers. Microfilming is a photographing process which Department of Revenue Rule 136 specifically excludes from the definition of "manufacturer".

The Bank has also raised factual exceptions to the measure of the Manufacturing business and occupation tax and use tax assessed on the embossing and microfilming activities. The auditor was required to estimate the amounts involved, but the Bank has now prepared a compilation of the actual amounts and requests this be reviewed.

3. Business and occupation tax under the Retailing or Wholesaling classifications is assessed on "repossession sales". In question are 90-day recourse and full recourse dealer arrangements under which the Bank finances the sale of automobiles, large and small trucks, motor homes, and recreational vehicles. The Bank explains these two financing arrangements as follows.

90-Day Recourse.

In a 90-day dealer arrangement, an automobile dealer will strike a bargain with a potential customer. The dealer and the customer enter into a "Conditional Sale Contract and Security Agreement" covering the vehicle in question. The contract will call for a down payment and specific monthly payments by the purchaser. The Bank promulgates its own forms for use by auto dealers. The customer takes delivery of the car. Assuming that the Bank agrees the credit of the customer is satisfactory, the dealer will assign a conditional sale contract to the Bank by executing on its reverse side of the contract a paragraph entitled "Sale of Chattel Paper – Assignment and Guarantee of Security

Agreement". If in the future the customer defaults on payments due the Bank, the Bank will repossess the automobile and deliver it to the guaranteeing dealer. The dealer is then billed by the Bank for the net loan payoff amount and the dealer pays the net loan payoff amount to the Bank. The net loan payoff amount is unrelated to the value of the car and is calculated by the Bank from its principal, interest and penalty accounts.

Full Recourse.

In a full recourse situation, the customer deals with the automobile dealer in the same fashion. When assigning the conditional sale contract to the Bank, the dealer executes on its reverse side a "Sale of Chattel Paper – Seller's Assignment and Special Guarantee". Within 60 days of default by a customer, the Bank will notify the dealer of the default and bill the dealer for the net loan payoff amount. The Bank does not typically repossess the vehicle covered by the conditional sale contract. Again, the net loan payoff amount is paid by the dealer to the Bank and the dealer then exhausts his recourse against the customer, including repossession or other efforts to take possession of the vehicle.

In both these situations the Bank contends it is merely recovering amounts guaranteed it under the original security agreements and that "sales", as defined by RCW 82.04.040, do not occur. It is also stressed the amounts repaid pursuant to the guarantees do not represent "selling prices" but instead represent outstanding loan balances which are in no way related to the market value of the property financed.

4. The Service and Other Activities business and occupation tax is assessed on disallowed deductions taken by the Bank under RCW 82.04.430(11) for ". . . interest received on . . . loans primarily secured by first mortgages or trust deeds on nontransient residential properties". The exceptions to this adjustment are factual and have been explained by the Bank as follows.

In order to report for business and occupation tax purposes the amount of deductible interest from gross income, the Bank

has issued a General Policies and Procedures Bulletin # C885.01 applicable to the subject. The bulletin is issued to all branch Banks and outlines the necessary reporting procedures. The report is prepared monthly by each branch and submitted to the head office tax department for total summarization. The branch report indicates the total interest received on residential loans secured by first mortgages or trust deeds and separates the amount between transient (taxable) and nontransient (nontaxable) residential properties. The amount of the interest reported as nontransient (nontaxable) is the amount deducted from business and occupation taxable gross income. The Bank concedes that errors can occur in branch reporting and agrees that sample testing is necessary to prove the accuracy of the deduction. The Bank does not agree, however, with the method of sampling employed by the Department in arriving at the alleged overstatement of nontaxable interest.

The Department's method defined the "population" to be sampled, as all of the individual loan receipt tickets in support of branch reports. From the summary of the branch reports for the years 1972 and 1973, eight branch reports and their supporting tickets for the month of June were chosen for sampling. Tickets applicable to transient (taxable) properties were not sampled or tested which could have favorable errors for the Bank. Sampling was directed only to tickets applicable to nontransient (nontaxable) properties which would indicate only unfavorable errors to the Bank. In addition, the branches were selected by review rather than random sampling. The nontransient (nontaxable) tickets for the eight branches were received to determine if information thereon was sufficient to identify the interest as nontaxable. If it was, then the ticket was set aside. If it could not be so identified, it was set aside for testing. After all tickets were reviewed those set aside for testing were scheduled and totaled for "interest on tickets to be tested". This total represented 100% of the sample. Tickets set aside for testing were reviewed with the supporting loan documents. If the loan document indicated that interest was taxable, the amount became an exception. After all tickets were reviewed, the exception tickets were totaled and the total compared to the total

"interest to be tested". The resulting percentage is identified as the "taxable percentage of interest on tickets tested".

The sampling method used by the Department of Revenue is contended to be deficient in application. The nontransient (nontaxable) tickets were all given an equal chance of being sampled and tested (only those that looked wrong were tested). The transient (taxable) tickets were not given a chance at all to be sampled or tested for errors occuring which would be favorable to the Bank. Subsequent to the receipt of the tax assessment, the Corporate Auditing Department of the Bank prepared a random sample estimation of errors in accordance with accepted methods of statistical sampling. The population sampled was the same as sampled by the Department for the month of June 1972 and 1973. Instead of choosing certain branches and only tickets pertaining to nontransient (nontaxable) properties, all tickets in the population were given an even chance for sampling. The method used is recommended by the Bank Administration Institute in its publication "Statistical Sampling for Banks". It consisted of selecting a reliability level of 95 percent. Given 95 percent with a precision limit of 2 percent, the number of tickets to be chosen on a proportional sampling situation is approximately 150. The number of tickets selected for sampling was 142 for 1972 and 147 for 1973. A random point was selected in which to start and tickets were chosen as interest accumulated to $7,796 in 1972 and $8,982 in 1973.

5. By letter dated August 29, 1975 the Bank has also petitioned for refund or offset of business and occupation tax paid under the Service and Other Activities classification during the years 1972 and 1973 on outgoing interchange settlement fees resulting from Master Charge Operations. The Bank explains that it is a member of the Interbank Card Association's Master Charge System which acounts for and distributes merchants discounts on a predetermined interchange fee method comparable to the BankAmericard.

The Bank issued a general purpose Master Charge Card for use of the person named thereon. Merchants who desire to honor

the card in connection with sales of merchandise enter into a "Firstbank Master Charge Merchants Agreement" with the Bank. The merchant agrees to offer to the Bank sales drafts relating to the Master Charge sales and the Bank agrees to purchase such drafts on a predetermined discount basis. The discount is known and accounted for as "merchants discount". Merchants discount applicable to sales to the Bank's card holders is income to the Bank and credited on a daily basis. Merchants discount applicable to sales of another Master Charge Card issuing Bank is distributed under an interchange transaction. The predetermined portion of the merchants discount (outgoing interchange fee) is credited to the card issuing bank and available for withdrawal on a daily basis.

The Bank also has Master Charge agreements with correspondent banks. These are banks that do not issue Master Charge Credit Cards but in accordance with the Agreement will issue Firstbank Master Charge Merchant Agreements and accept merchant sales tickets for deposit. The sales tickets are offered to the Bank on a sales draft in the same manner as from a merchant. The Bank purchases the sales draft and the merchants discount is distributed to the correspondent bank and a card issuing bank under an interchange transaction. The predetermined portion of the merchants discount (outgoing interchange fee) is credited to the correspondent bank and the card issuing bank and available for withdrawal on a daily basis.

The Bank contends that under its contract with Interbank Card Association, it is a mere conduit in effecting distribution of the merchants discount to banks involved in the Master Charge System and claims refund of taxes paid in the amount of $12,919.39 in error on the merchants discount distributed.

DISCUSSION:

1. WAC 458-20-194 provides, in part, that

> Persons engaged in a business taxable under the Service and Other Business Activities classification and who maintain places of business both

> within and without this state which contribute to the performance of a service, shall apportion to this state that portion of gross income derived from services rendered by them in this state. Where it is not practical to determine such apportionment by separate accounting methods, the taxpayer shall apportion to this state that proportion of total income which the cost of doing business within this state bears to the total cost of doing business both within and without this state.

On the basis of the Bank's explanation, we are of the opinion that the Nassau branch does constitute a foreign out-of-state branch place of business which contributes to the performance of the Bank's international banking services. We feel this is clearly the case as the Nassau branch was created pursuant to the Federal Reserve Act to permit the bank to engage in international banking services, which it otherwise could not do. Accordingly, under Rule 194, we conclude the Bank is entitled to apportion from the measure of this state's business and occupation tax income derived from services contributed to by its Nassau branch.

2. RCW 82.04.120 defines the term "to manufacture" to embrace

> . . . all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commerical or industrial use, . . .

"Commercial or industrial use" is defined by RCW 82.04.130 to mean

> . . . the following uses of products, including byproducts, by the extractor or manufacturer thereof:

(1) Any use as a consumer; and
(2) The manufacturing of articles, substances or commodities.

RCW 82.04.190 defines "consumer" to include

(1) Any person who purchases, acquires, owns, holds, or uses any article of tangible personal property irrespective of the nature of his business . . . other than for the purpose (a) of resale as tangible personal property in the regular course of business.

. . .

(2) Any person engaged in any business activity taxable under RCW 82.04.290.

With these definitions in mind we will take up the specific activities in question.

A. *Credit Card Embossing.*

These plastic cards are processed by the bank through a machine which, by the application of heat and pressure raises letters on the face of the card indicating the card holder's name and various identification data. Additionally, a magnetic stripe is attached to the back of the card containing electro magnetic data for cash machine purposes. In our view, this clearly constitutes the production of new, different, or useful articles of tangible personal property so as to fall squarely within the intent of RCW 82.04.120. The process commences with blank plastic pieces having no discernible utility and little value and upon completion produces new, different and useful articles having great utility and value in the financial world. Thus, we feel the Bank's reliance on Excise Tax Bulletin 213 is not well placed as the situation at hand is distinguishable on the facts, i.e., the result achieved in embossing these credit cards consists in making a new article with a new use and does not merely extend a utility already had by the blank card. We feel further

these cards are unquestionably tangible personal property as they are physical, perceptible by the senses and can, in fact, be held in hand. These cards have actual form and substance and are corporeal in every sense.

These cards are manufactured for the Bank's "commercial or industrial use" as a consumer because such cards are not resold by the Bank in the regular course of business but rather, are distributed free of charge in connection with the banking services provided which services are taxable under RCW 82.04.290 (see RCW 82.04.190(2) above). Also RCW 82.12.010(5) defines "Consumer" to mean

> . . . any person who distributes . . . or causes to be distributed . . . any article of tangible personal property . . . the primary purpose of which is to promote the sale of . . . services.

Further, a donor of tangible personal property is a user-consumer of such property as illustrated in WAC 458-20-178 which provides that

> The use tax supplements the retail sales tax by imposing a tax of like amount upon the use within this state as a consumer of any article of tangible personal property purchased at retail or acquired by lease, gift, or bailment, or extracted, produced or manufactured by the person so using the same, where the user, *donor* or bailor has not paid retail sales tax under Chapter 82.08 RCW with respect to the sale to him of the property used. (Emphasis ours.)

Finally, the creation of visual images by artists and portrait photographers represents personal professional services which WAC 458-20-136 treats as non-manufacturing activities. The creation of bank credit cards by the described machine process is clearly a "manufacturing" activity which results in more than just a mere creation of visual images. A finished plastic credit card is produced with not only raised lettering on the face but with a magnetic stripe on the back containing electro magnetic

code symbols for cash machine purposes. This is a "new, different or useful . . . article of tangible personal property . . . produced for . . . commercial or industrial use . . ." (RCW 82.04.120). The Manufacturing business and occupation tax and use tax assessed on this activity are sustained.

B. *Duplicating.*

Photocopying, Xeroxing, or any other method of duplication fall within the definition to "to manufacture" at RCW 82.04.120 as the result is the production of ". . . new, different, or useful . . . [articles] of tangible personal property". These articles are for the Bank's "commercial or industrial use" since they are not resold in the regular course of business but used internally by the Bank as a consumer (RCW-82.04.190(1) and (2)). It goes without saying a blank piece of paper has very little, if any, utility. Paper that has received printed copy is clearly new, different, or useful and has a new utility. We conclude the operation of the Duplicating Department constitutes "manufacturing" with the exception of the two selectric typewriters, which activities are not manufacturing pursuant to WAC 458-20-147. The cost of operating the two typewriters will be deleted from the value of products subjected to tax. In all other respects the manufacturing of business and occupation tax and use tax are sustained.

C. *Microfilming.*

On the basis on the above discussion we conclude microfilming also falls within the term "to manufacture" as it clearly meets the statutory requirements. Microfilm is produced for the Bank's "commercial or industrial use" as it is not resold in the regular course of business but rather, is used internally by the Bank as a consumer (RCW 82.04.190(1) and (2)). It is immaterial that this activity is required by the Bank Secrecy Act or is performed because of the Bank's security requirements as the reasons why taxable activities are engaged in do not control application of the tax. The fact that WAC 458-20-136 lists a portrait photographer as a non-manufacturer does not mean that microfilming is also not manufacturing. A portrait photographer performs a personal professional one-of-a-kind service. Microfilming is a machine process which, in the Bank's case,

reduces and duplicates commercial paper to a size convenient for storage. This clearly meets the definition of "to manufacture" at RCW 82.04.120 and to attempt to equate the two processes merely because each involves photography is not persuasive. The Manufacturing business and occupation tax and use tax assessed on this activity are sustained.

The factual exceptions to the measure of the Manufacturing business and occupation tax and use tax asserted against the embossing and microfilming activities will be resolved by the Department's Field Operations Division on the basis of the compilation of actual amounts prepared by the Bank.

3. The reverse side of the Bank's "Conditional Sale Contract and Security Agreement" covering motor vehicles contains the following pertinent language regarding the Bank's 90-day Recourse and Full Recourse security arrangements.

> 10. ASSIGNMENT. Seller may assign this contract, and any such assignment shall vest in the assignee of the Seller all of the Seller's rights together with title to said property, and in such event wherever the word "Seller" is used herein, it shall be taken to mean its assigns and all payment required to be made hereunder by Buyer shall be paid in full to such assignee . . .
>
> . . .
>
> SECURITY AGREEMENT - SALES OF CHATTEL PAPER ASSIGNMENT AND GUARANTEE OF SECURITY AGREEMENT.
>
> . . .
>
> If Bank gains possession of said property or any part thereof and delivers it to the undersigned, or commences legal proceedings to gain such possession, within ninety (90) days after the then unpaid installment longest overdue; upon delivery of said property

by Bank, the undersigned agrees (a) to hold the property as bailee of Bank and when so authorized by Bank to endeavor to sell the property promptly and sell it in a commerically reasonable manner, and in accordance with all the terms and conditions of such a sale imposed by law, and (b) to transmit to Bank, immediately upon sale, the entire unpaid balance of this contract plus the Bank's collection expenses; and (c) if the property is not sold within thirty (30) days after delivery of the property, to pay to Bank forthwith the entire balance of the contract, plus the Bank's collection expenses.

. . .

SECURITY AGREEMENT - SALE OF CHATTEL PAPER SELLER'S ASSIGNMENT AND SPECIAL GUARANTEE.

For valuable consideration, the undersigned does hereby sell and assign unto Seattle-First National Bank the within described contract, the property covered thereby, and all proceeds thereof, and all monies due or to become due thereunder. The undersigned warrants that the obligation of the buyer is valid and enforceable in accordance with its terms and is not subject to any defenses. The undersigned further hereby guarantees the payment of all monies due or to become due under the terms of said contract and further guarantees the prompt and faithful performance of each and every covenant thereof by buyer. In the event of any nonpayment by the buyer for any reason, the undersigned, upon demand, hereby agrees to pay Bank the entire balance of payments and obligations, accrued and unaccrued, with accrued interest and all other charges incurred by Bank.

Under these agreements the Bank recovers only the balance of original sale amounts due it under defaulted conditional sale contracts. Upon payment of such amounts title to vehicles is

transferred from the Bank to the dealer and it is this transaction which has been subjected to business and occupation tax and is in question. In our opinion the Bank did not participate in these transactions "as a seller" of tangible personal property subject to business and occupation tax on sale proceeds, but rather, engaged in furnishing the financing for vehicle dealers to engage in business as "sellers". While the Bank held title to the vehicles, this was bare title for security purposes only and the Bank did not make "sales" under RCW 82.04.040 when this title is transferred to dealers upon satisfaction of their financial guarantees. The business and occupation tax in question will be deleted from the audit assessment.

4. The factual exceptions to the Service and Other Activities business and occupation tax assessed on disallowed deductions for interest received on loans primarily secured by first mortgages or trust deeds on nontransient residential properties will be reconciled by the Department's Field Operations Division on a basis of the random sample estimation prepared by the Bank's Corporate Auditing Department.

5. Regarding the outgoing interchange settlement fees resulting from Master Charge operations, the by-laws of the INTERBANK CARD ASSOCIATION provide, in pertinent part, as follows:

> 11.09 Interchange And Cash Advance Accommodation Fees.
>
> (a) Purpose of Fees. The interchange fee and the cash advance accommodation fee are designed to compensate a member for particular expenses which it incurs as the result of interchange transactions. For sales transactions, various elements of expense make up the interchange fee, including costs of processing, cost of money and increased risk due to the use of Interbank Cards in interchange transactions. For interchange cash advances, various elements of expense make up the accommodation fee, including costs of processing cash advance slips and the cost of money.
>
> * * *

(c) Payment of Fees. The payment of interchange fees and cash advance accommodation fees shall be accomplished by direct net settlement between members on the appropriate Interbank Transmittal Summary and Draft. Interchange fees are payable by the acquiring member to the issuing member. Cash advance accommodation fees are payable by the issuing member to the acquiring member. The payment of these fees is reversed for chargeback and credit items. Each interchange transaction between members shall result in the payment of the appropriate interchange fee or cash advance accommodation fee, as a case may be.

In view of the Bank's explanation of the circumstances surrounding these fees, we are of the opinion the matter is resolvable on the basis of a previous ruling issued by the Department regarding the same fees resulting from BankAmericard operations. This ruling reads as follows:

Banks participating in the system under class A agreements issue bank cards in their own name. Handling fees and/or discounts accrue to the taxpayer for servicing sales drafts from participating merchants on the bank cards issued by other banks.

* * *

Class B accounts are maintained with the smaller banks who utilize the taxpayer's merchant agreements. These are banks who do not have the sophisticated computer capacity to handle BankAmericard accounting procedures. Class B banks forward the full sales draft received from merchants to the taxpayer and at the end of each month the taxpayer distributes back to Class B banks one percent of the three percent discount fee paid by merchants.

The taxpayer takes the position that reimbursement fees distributed to Class A banks and the portion of discount fees paid to Class B banks should not be

treated as income to the taxpayer. The taxpayer argues that under its contract with BankAmericard it is a mere conduit in effecting distribution of the card as reimbursement fee to Class A banks. The taxpayer terms the fees "transient income" which are retained for less than 24 hours. The taxpayer acknowledges that immediate distributions are not made to Class B banks.

* * *

DISCUSSION:

1. *BankAmericard Handling Fees and Discounts.* Operating regulations governing interchange transactions between banks participating in the BankAmericard system under Class A agreements (banks issuing cards in their own name) clearly require payment of a reimbursement fee by a clearing member (in this case the taxpayer) to the card issuing bank. We conclude from the information provided that the taxpayer acts as a mere conduit in the distribution of this required reimbursement fee to card issuing banks. Accordingly, tax assessed against a portion of the discount fee paid over to card issuing banks will be deleted from the assessment.

We cannot reach the same conclusion with respect to amounts paid over to Class B banks. Here the taxpayer is a direct recipient of discounts collected from merchants. Class B banks do not issue bank cards in their own name nor do they maintain their own merchant agreements. Under these circumstances, the fact that a portion of the discounts received by the taxpayer are returned to other participating banks (one percent of a three precent discount fee) does not serve to reduce the "gross income" of the taxpayer (see RCW 82.04.080). Tax is due as assessed on gross discount income received through Class B BankAmericard transactions.

Thus, the outgoing interchange fees distributed to Master Charge card issuing banks is not subject to business and occupation tax and a credit or offset for such tax paid will be prepared. Outgoing interchange fees distributed to banks who do not issue Master Charge cards is correctly includable in the Bank's "gross income of the business" and taxable.

DECISION AND DISPOSITION:

The Bank's petitions are sustained regarding Item 1, Nassau branch income and Item 3, repossession sales. To the extent indicated the petitions are partially sustained regarding Item 2-B, Duplicating and Item 5, Outgoing Interchange Settlement Fees.

The factual exceptions regarding the measure of Manufacturing business and occupation tax and use tax asserted against the embossing and microfilming (Item 2) as well as to the Service and Other Activities business and occupation tax asserted on the interest income (Item 4) will be resolved by the Department's Field Operations Division.

In all other respects the petitions are denied. The file is being referred back to the Field Operations Division in order that the tax corrections required by this Determination may be completed. When this additional auditing is completed, a revised tax assessment will be issued which will be due and payable in full on or before the due date shown thereon.

DATED this 30th day of March, 1976.

STATE OF WASHINGTON DEPARTMENT
OF REVENUE

/s/ Don R. McCuiston

Don R. McCuiston, Senior Hearing Officer

STATE OF WASHINGTON
DEPARTMENT OF REVENUE
OLYMPIA 98504

June 15, 1976

Law Offices of
Davis, Wright, Todd, Riese & Jones
4200 Seattle-First National Bank Bldg.
Seattle, Washington 98154

SUPPLEMENTAL
DETERMINATION

No. 76-29A

Re: Seattle-First National Bank
Reg. No. J578 049 247
Tax Assessment 85687

Attn: C. James Judson

Dear Mr. Judson:

Your letter of May 24, 1976 to our Mr. John Okimoto, which refers to Determination 76-29, dated March 30, 1976 has been referred to the writer for reply. Specifically, you refer to Item 1., which involves business and occupation tax asserted on income derived from financial services participated in by the Bank's branch in Nassau, the Bahamas. While in its July 23, 1975 petition for correction of assessment, the Bank contended this income should be fully exempt this state's business and occupation tax, the hearing officer concluded that since both the Bank's Seattle Headquarters and the Nassau branch participate in the generation of the income, apportionment was in order in line with WAC 458-20-194. This is provided at Page 9 of the Determination and the following language:

> Accordingly, under Rule 194, we conclude the Bank is entitled to apportion from the measure of this state's business and occupation tax income derived from services contributed to by its Nassau branch.

However, in the DECISION AND DISPOSITION the Determination provides, at Page 16, that

> The Bank's petitions are sustained regarding Item 1., Nassau branch income . . .

You take the position that this latter language sustains the taxpayer's argument for full exemption in its July 23, 1975 petition for correction of assessment and you urge the Department's Field Operations Division to correct the audit deficiency on this basis.

Your understanding of Determination 76-29 does not reflect the intent of the Determination and any inconvenience caused you by this misunderstanding is regretted. It is the intent of the Determination to permit only apportionment of the income participated in by the Nassau branch as discussed at Page 9. So there will be no further misunderstanding: the first sentence under "DECISION AND DISPOSITION" at Page 16, of Determination 76-29 is hereby deleted and in its place the following language is substituted:

> The Bank's petition regarding Item 3., repossession sales, is sustained. The Petition regarding Item 1., Nassau Branch income, is partially sustained to the extent that apportionment from the measure of this state's business and occupation tax of income derived from services contributed to by the Nassau branch is permitted pursuant to WAC 458-20-194.

A copy of this letter is being furnished to the Department's Field Operation Division in order that the audit may be corrected to reflect apportionment of the income in question. We trust this clears the matter up.

Sincerely,

STATE OF WASHINGTON
DEPARTMENT OF REVENUE
INTERPRETATION AND
APPEALS DIVISION

/s/Don R. McCuiston

Don R. McCuiston,
Senior Hearing Officer

DRC:70/49

cc: Seattle-First National Bank

Attention: John T. Mudge, Vice President
Douglas D. Schindele, Assistant Vice President
Michael J. Welch, Assistant Vice President

John Okimoto, Supervising Auditor
Department of Revenue

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
) No. 82A-1785-DB
CROCKER NATIONAL CORPORATION)

Appearances:

For Appellants: Franklin C. Latcham
James Kleier
Attorneys at Law

For Respondent: Karl F. Munz
Counsel

OPINION

This appeal is made pursuant to section 25666[1] of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Crocker National Corporation against proposed assessments of additional franchise tax in the amounts of $217,898 and $114,645 for the income years 1975 and 1976, respectively.

This appeal involves two issues. The first is whether, for property and sales factor purposes, respondent properly assigned to California all of Crocker National Bank's investment in, and rental receipts from, tangible personal property leased to others and physically located in states in which the bank was shielded from state taxation by virtue of Public Law No. 93-100. The second issue is whether, again for property and sales factor purposes, respondent correctly assigned to California the loans (and interest income therefrom) that federal banking regulatory authorities attributed to Crocker National Bank's Cayman Islands branch office.

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[1] Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

The first issue concerns only the 1976 income year and involves tangible personal property which appellant's unitary subsidiary, Crocker National Bank (hereinafter referred to as Crocker), owned and leased to others. During the year in question, all of this property was physically located in states other than California, and Crocker was insulated from state taxation in every state except California, because of Public Law No. 93-100.[2] For property and sales factor purposes, respondent attributed to California all of Crocker's investment in, and rental receipts from, this property. Originally, this was done by respondent's audit staff pursuant to a published "guideline" respondent had developed to govern the apportionment of income earned by banks and financial corporations. Subsequently, respondent adopted a regulation (Cal. Admin. Code, tit. 18, reg. 25137-4) to replace the guideline, and, since respondent did not make the regulation prospective only in application, it is fully retroactive to all open years. (See Rev. & Tax. Code, § 26422; *Appeal of BanCal Tri-State Corporation*, Cal. St. Bd. of Equal., Mar. 4, 1986.)

The provisions of the regulation applicable to leases of tangible personal property for property factor puurposes state as follows:

> Where the taxpayer leases tangible personal property to another the entire cost of such property shall be attributed to the state of the taxpayer's commercial domicile unless the taxpayer establishes, or the Franchise Tax Board is able to establish the location of such property in another state or states for the entire year and the taxpayer is taxable in the state or states where the property is located.

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[2] The pertinent part of Public Law No. 93-100 provided that, for any taxable year beginning on or after August 16, 1973, and before September 12, 1976, no state could levy any kind of "doing business" tax, including a tax measured by income, on an insured depository like Crocker, unless the principal office of the depository was located in that state. Thus, for Crocker's income year 1976, which began January 1, 1976, this Public Law prohibited any state but California (where Crocker's principal office is located) from taxing Crocker's in-state business activities.

(Cal. Admin. Code, tit. 18, reg. 25137-4, subd. (d)(1)(B)(iii).)

With respect to the sales factor, the regulation provides:

> Receipts from the lease or rental of tangible personal property shall be attributed to the state of the taxpayer's commercial domicile unless the taxpayer or the Franchise Tax Board is able to establish the location of such property in another state or states for the entire year and the taxpayer is taxable in the state or states where the property is located.

(Cal. Admin. Code, tit. 18, reg. 25137-4, subd. (c)(2)(A).)

Respondent contends that the cost of the leased property and the receipts from the leases were properly assigned to California, the state of Crocker's commercial domicile, because Crocker was not taxable in any other state, by virtue of Public Law No. 93-100.

Section 25122 provides that a taxpayer is taxable in another state if:

> (a) in that state it is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (b) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

Since no contention is made that Crocker was actually subject to any tax in the states in which the leased property was located, the only question is whether those states had jurisdiction to impose a net income tax on Crocker. According to respondent's regulations, this second test of taxability "applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States." (Cal. Admin. Code, tit. 18, reg. 25122, subd. (c) (art. 2.5).) In this case, Public Law No. 93-100 deprived every state but California of jurisdiction to levy an income tax on Crocker's activities. It

is clear, therefore, that Crocker was not taxable in those states within the meaning of the applicable statutes and regulations. Consequently, respondent acted properly and in accordance with regulation 25137-4 in assigning the values arising from Crocker's leases to California.

The second issue concerns the Cayman Islands branch which Crocker established in 1973 to serve its international customers. Crocker had no employees in the Cayman Islands to staff this branch, and it apparently did not establish an independent office location there. Rather, it retained the Bank of Montreal Trust Corporation to act as its agent in the Cayman Islands, to maintain records and accounts of the Cayman branch, and to file the financial reports required by the laws of the Cayman Islands. Crocker made loans to its foreign customers through this branch which were recognized by both federal banking regulatory authorities and the Cayman Islands' authorities as being made from and as assets of the Cayman Islands branch. For property and sales factor purposes, respondent assigned these loans and the interest therefrom to California, where all of the activities performed by Crocker's own employees with respect to the loans actually took place.

Regulation 25137-4 provides, for property factor purposes, that loans are to be assigned to a particular state in the following manner:

> Assets in the nature of loans (including federal funds sold and banker's acceptances) and installment obligations shall be attributed to this state if the office of the bank or financial corporation at which the customer applied for the loan is located in this state *except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located.* For purposes of this subclause, the word "applied" means initial inquiry (including customer assistance in preparing the loan application) or submission of a completed loan application, whichever occurs first in time. (Emphasis added.)

(Cal. Admin Code, tit. 18, reg. 25137-4, subd. (c)(1)(B)(ii)(I).)

The regulation assigns loan interest in an identical fashion for sales factor purposes:

> Interest and other receipts from assets in the nature of loans (including federal funds sold and banker's acceptances) and installment obligations shall be attributed to this state if the office at which the customer applied for the loan is located in this state *except in cases where the loan is recognized by appropriate banking regulatory authority as being made from and as an asset of an office located in another state, in which case it shall be attributed to the state where that office is located.* For purposes of this clause, the word "applied" means initial inquiry (including customer assistance in preparing the loan application or submission of a completed loan application) whichever occurs first in time. (Emphasis added.)

(Cal. Admin. Code, tit. 18, reg. 25137-4, subd. (c)(2)(B)(i).)

On its face, the regulation appears to require that the loans and interest be assigned to the Cayman Islands, since it is undisputed that all banking regulatory authorities considered the loans as made from and as assets of the Cayman Islands branch. Respondent contends, however, that this branch was not really an "office" and wasn't "located" in the Cayman Islands within the meaning of the regulation. The basis for this position is respondent's view that the Cayman Islands branch was a mere "shell" or "paper" entity lacking in substance.

We believe that the regulation does, in fact, require that the loans and loan interest be attributed to the Cayman Islands. The clear thrust of the plain language of the regulation is to assign loans to the office where they are "booked" as assets, when that location differs from the place where the customer applied for the loan. Here, federal banking regulatory authorities recognized the loans as "booked" at Crocker's Cayman Islands branch. If that branch constitutes an office for "booking"

purposes, no substantial reason appears why it shouldn't also constitute an "office" for purposes of regulation 25137-4. The regulation certainly does not state that an "office" must possess certain specific characteristics. Had respondent so intended, it could easily have included a definition of "office" in the regulation; indeed, it may still do so, if it chooses to amend the regulation. In our view, however, Crocker's Cayman Islands branch certainly had sufficient substance to constitute an office for present purposes. It was licensed by the Cayman Islands government, which imposed an annual license fee on Crocker, and it was specifically authorized and recognized by the Federal Reserve Board as a foreign branch banking facility actually located in the Cayman Islands.[3] Under these circumstances, we do not believe that this branch can fairly be classified as a mere "shell" or sham facility.

For the above reasons, respondent's action will be modified to reflect our determination that the loans and loan interest were properly attributable to the Cayman Islands for factor purposes.

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[3] The Federal Reserve Board in fact required Crocker to advise it when the branch opened for business and where its "exact location" was. It further required notification of any future changes in location of the branch, and it also specifically authorized Crocker to contract with another party to provide "quarters, staff, and bookkeeping" for the branch.